BRITISH WAR FINANCE

AND THE CONSEQUENCES

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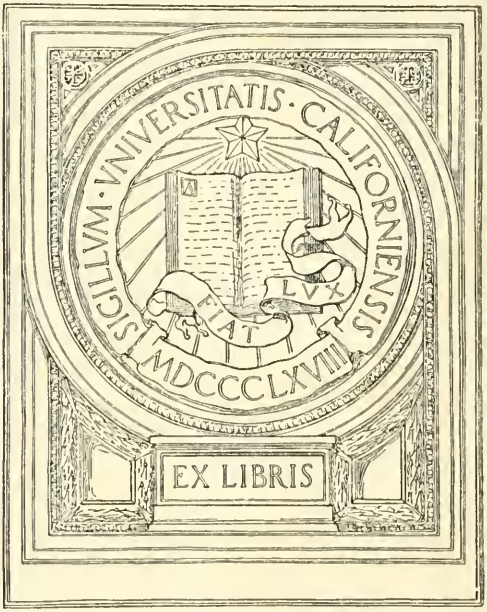

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BY

T. J. KIERNAN, M.A.

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FOREWORD

I SHOULD mention that this little book reproduces a dissertation which was part of the work prescribed me by the National University of Ireland for the M.A. Degree in Economics this year. There are a few slight alterations bringing some statistics to date.

At the suggestion of my Professor of Economics at University College, Dublin, Rev. T. A. Finlay, M.A., the dissertation is published, in the hope that it may serve as a source of general information, and, it may be, even throw some new light on a subject which has been forced upon the attention of all of us within recent years—the great change in living, or rather in securing the means of living, which is one of the sad results of the war. The pre-war English financial system, the measures taken to adapt the system to war conditions, and the state of the finances after the armistice, are dealt with in turn. The study is carried to the end of the financial year 1919–20, and matters of cardinal importance are treated in the necessary detail. To have minutely examined subjects which are connected with, but are not an integral part of, the finance of the war period would have largely increased the

size of this volume, and destroyed the proportions of the original work. For this reason, such questions of current and quite recent interest as the Capital Levy; the threatened fiasco of the Excess Profits Duty as a productive tax; the various schemes that have been proposed to ease the financial situation, some by deflating the currency, others by means of a further inflation; the dear and cheap money controversy; the attempt to increase wages by decreasing production—one of the aims of an enlightened democracy; and that other attempt to place a legal limit on currency-issues, while leaving unrestricted the buying capacity of the people—the considered act of an enlightened bureaucracy, these questions are not discussed here. I have rather endeavoured to make clear the underlying facts in the War Finance of the United Kingdom. The study has enabled me to appreciate, I trust correctly, the results of that finance; I venture to hope that even those to whom the subject is new may derive a similar benefit from a perusal of this volume.

University College,
Dublin, *November*, 1920.

CONTENTS

CHAPTER I PAGE

A Pre-War Study: The Financial System of Great Britain 1

CHAPTER II

1914: *A*—The Shock to Credit; *B*—Currency Measures 14

CHAPTER III

Public Finance in War Time, 1914–1920 . 34

CHAPTER IV

The War Finance from other View-Points: 1. Currency-Issues and Prices; 2. Interest; 3. Profits; 4. Wages . . 56

CHAPTER V

The Foreign Exchanges . . . 109

CHAPTER VI

The Effect of the War on the Financial System of Great Britain . . . 124

APPENDICES 133

BRITISH WAR FINANCE

CHAPTER I

A PRE-WAR STUDY; THE FINANCIAL SYSTEM OF GREAT BRITAIN

INDUSTRY creates goods; Finance facilitates the exchange of goods. The instruments by which Finance performs this task are specially chosen ones, i.e., Currency and Credit. Industry is essential to life, "In the sweat of thy face shalt thou eat bread." Finance, with its instruments, credit and currency, has been devised by civilised man for his convenience; it is not essential to the production, nor even to the exchange, of goods. If a more efficient device were discovered, the present one might be dispensed with. For this reason, and also because the system is capable of being put to many different uses, of which some are very questionable, it is a useful and at the same time an interesting study to trace its workings during a period when systems were tried in the crucible of war, and inherent defects could not fail to come into prominence. Our study of Great Britain's Finances during the War will embrace a pre-war year, or a number of pre-war years for some statistical purposes, and will extend beyond the date when hostilities between the great warring Powers ceased, to the end of the financial year 1919–1920.

Finance, we have said, for its proper functioning, requires the aid of Currency and Credit. In pre-war times the Currency of the United Kingdom was supplied by the Royal Mint, a Government Department independent of the Treasury; and also, under very strict control, by public Companies called Banks; while British Credit was manufactured by non-government bodies, accepting houses, discount houses, bill-brokers, and joint-stock banks, all working under the protection and ultimate controlling influence of the Bank of England; and Finance, whether Government Finance or private Finance, employed for its purposes the counters of currency and credit thus provided.

In this connexion, the modern State may be said to have two economic functions: the monetary and the fiscal. In England before the war the Government kept its monetary, or currency-manufacturing, department strictly apart from its fiscal or State-purse department. When the State needed money it could obtain it by two legitimate means (*a*) by a loan authorised by Parliament, (*b*) by taxation authorised by Parliament; the third means by which Governments obtain funds, namely, by dilution of the currency, was, under the conditions which are about to be described in detail, absolutely excluded.

The monetary function of the State was performed by the Royal Mint; there gold bullion was coined, gratis on demand, into sovereigns and half-sovereigns. In practice, bullion was brought to the Bank of England where it was

exchanged for sovereigns at a discount of $1\frac{1}{2}d.$ per standard ounce; for it was more convenient for the importer of bullion to get £3 17*s.* 9*d.* per ounce at once at the Bank than to wait his turn at the Mint and get £3 17*s.* $10\frac{1}{2}d.$

The pre-war currency system of Great Britain dates from 1844, when the Bank Charter Act was passed; though a change in the relative importance of the different forms of currency has since taken place. In 1844 bank notes were regarded as of prime importance, whereas in 1914 the notes had largely passed out of use, having been superseded by the cheque; they were employed chiefly by bankers as "till money," and were sometimes used for effecting payments where a cheque might not be acceptable, e.g., in the discharge of travelling expenses.

With a currency of notes, cheques and coin in use one looks for the standard by which the value of these is measured; just as in measurements of extension, for example, one looks for a standard of linear measure. The Currency Standard in Great Britain was the gold sovereign. This standard dated from 1816; prior to which date England had been on a bimetallic standard; and, before that again, on a silver standard. When it is said that England possessed the gold standard, it is meant that the standard unit for the measurement of values, and the basic medium of exchange, was the gold sovereign. The proof of the existence of a pure gold standard in a country is the power of obtaining gold immediately and unconditionally at par value, in exchange for any other form

of currency in circulation. The pre-war currency of Great Britain could stand this test, and England could boast of this as a distinction unique amongst the currencies of the world.

The maintenance of the gold standard required very careful management of the gold reserve of the Kingdom ; for if a sudden big drain to foreign countries reduced the supply, prices would be always unsteady. The management of the reserve was in the hands of one institution, the Bank of England. It alone held a gold reserve. The other banks of the United Kingdom had no reserve of gold strictly speaking, their main defence against a drain on their resources being a balance at the Bank of England. Generally speaking, when gold was imported into England, it found its way to the Bank of England ; and when gold was exported, it was taken from the Bank of England by the exporter. If sovereigns or half-sovereigns were needed, the Bank of England was called upon to supply them, and the Banking Department of that institution obtained the requisite gold by returning notes to the Issue Department, while the Issue Department kept its gold partly in bullion and partly in coin, and sent bullion to the Mint to be coined when required. This stock of gold in the Issue Department of the Bank of England was the stock from which any drain of gold, for export, or for internal use, was drawn. What is called the Reserve of the Banking Department is, for the most part, not in gold but in notes. These are, however, perfectly secured because they are covered by gold in the Issue

Department, and could not have been issued in the first instance if the gold had not been available (I omit consideration of the notes covered by securities, allowed to the Issue Department, and amounting to £18,450,000). The gold in the Issue Department is, therefore, the real Gold Reserve of the United Kingdom. It can be increased only by the importation of gold from abroad in return for goods exported; State action is powerless to increase the supply of gold in the country.

As regards silver and copper, they are not legal tender, but are only coined to meet the convenience of the public in making exchanges involving small cash payments, such as the retail purchase of goods or the hire of labour; the issue is regulated strictly by the needs of the community. These are gauged by the Bank of England; whenever and wherever there is a shortage of token currency, the Bank of England is called upon to supply the need, and the authorities of the Mint are advised by the Bank of any exceptional demand.

Thus in normal times the Government, in relation to the supply of money, is confined to minting just as much coin as the needs of trade demand; by no possible expedient can it cause an inflation of the currency. There is no State interference whatever, beyond the machine-like operation of minting coin to meet the demands of the public.

In addition to the gold currency and the subsidiary coinage, Bank Notes formed part of the

pre-war currency. They were, however, comparatively little used, and, by the provisions of the 1844 Act, required a cover of gold in respect of any issue in excess of the issue at the time of the passing of the Act.

Far more important were the cheques drawn against deposits in the banks. The connexion and distinction between currency and credit is nowhere more clear than in the case of the cheque currency. A trader wants credit to finance his business; he applies to his bank for a loan; the bank credits him with the amount of the loan, thus giving him a fictitious deposit account, with the right to transform the credit into currency by means of the cheque. Over the cheque currency the Government has no control whatever. The banks are in this case the manufacturers of currency; and there is no legal check on the amount of currency they may manufacture. The number of cheques drawn on a bank's loans is limited only by the amount of credit a bank considers it wise to give to the public. But banks are usually prudent, and do not give credit unless the loan is well covered; so that in a true sense it may be said that cheques are drawn to the extent to which the trade of a people requires them. That the banks can outstep the limits of prudence is obvious, of course; and it has often been suggested that a legal limitation should be placed on their currency-manufacturing powers. But in England, especially since the recent big amalgamations, it is most unlikely that any bank will overdo the granting of credit, and thus lead

to a crisis which would ruin its own business along with that of its customers.

The only further point to be examined in the matter of the creation of currency and credit is: whether the Government has power to create credit, and if so what is the check on its power to do so? The way in which the Government could in pre-war days create credit was by obtaining the consent of Parliament to issue a loan; and the limitation and check here are obvious and very real. But there was a minor method which Parliament allowed in order to enable the Government to anticipate Revenue, namely, the method of "borrowing on Ways and Means Advances" from the Bank of England. The Government was, however, bound to repay these advances in the quarter following that in which they were obtained; and was thus prevented from creating big credits for indefinite periods. Other methods employed before the war for tiding over a slack time of revenue receipts were (*a*) borrowing on Treasury Bills—that is, selling bills (of three, six, nine or twelve months' duration) through the Bank of England and redeeming them when they fell due; and (*b*) issuing short term Exchequer Bonds which were in due course redeemed, out of revenue, of course, and not by the creation of fresh debt.

Thus it is seen that before the war currency and credit were controlled and regulated, not by the caprice of any political party, for the time being the Government, but by the legitimate demands of trade, including, of course, speculative trade,

which is a part of industry; and that the great barometer, as it were, of the country's needs in this direction was the Bank of England.

Attention has already been drawn to the importance of the Gold Reserve fund of the Bank of England. It was pivotal in all questions where gold had influence, i.e., in all questions of finance in the United Kingdom, in the days before August, 1914. To treat first of the connexion between the Reserve and the Foreign Exchanges:

It was quite a common remedy for an unfavourable exchange to raise the Bank of England's discount rate. During the war, however, it became clear that the Bank had become practically powerless in the matter of regulating the Exchanges. The explanation is to be found in the changes in the currency which have come about as a result of the war. When the currency of the United Kingdom was gold, or based on gold, the Bank of England felt every movement of gold whether of export or import. The other British banks relied on the Bank of England for gold. They held a small amount, particularly the banks with power of note-issue, although Bank of England notes were commonly used as cover for the notes of the smaller note-issuing banks; and gold was not kept in large quantities by any bank. If the Exchanges were favourable to England, owing perhaps to a development of trade, some gold had to be sent to England to meet the "balance" of indebtedness. Thus favourable Exchanges meant an inflow of gold, and the Bank Reserve was thereby strengthened,

and all was well. But if the Exchanges were going against England, because of an adverse balance of trade, it became profitable for English importers to pay for their imports in gold; that is to say (in the prior case the same remark applies) a point was eventually reached when it did actually become more profitable to export gold than to buy bills of exchange on Paris, Berlin or New York at an enhanced price. The exporter purchased the gold from the Banking Department of the Bank of England, which obtained the gold from the Issue Department by returning notes in exchange. These notes it took from its Reserve which was *pro tanto* reduced. Now, the ratio of this Reserve (of the Banking Department) to the amount of the immediate liabilities of the Bank—the "Public" and "Other" deposits—was an infallible index of the movements of gold and a sign of the monetary situation. If a big drain of gold for export was made, the ratio fell. This alarmed everybody, and nobody more than the Directors and Governors of the Bank of England. They would then raise the rate of discount. The Rate of Discount is the rate at which the Bank of England will discount bills of exchange or make advances on securities for short periods. It is, in other words, the rate which the Bank charges for giving a customer £100 worth of its credit. As soon as the Bank Rate is raised, the Market Rate, which is always somewhat lower than that of the Bank, follows it. This is because the Bank Rate is regarded as a standard rate, and depositors in

the other banks will look for a higher return for their money when the Bank of England rate goes up. Also, the Bank of England can force the Market Rate to follow its own rate in the upward move by borrowing large sums from the market and thus making money scarcer, that is to say, dearer. The high rate of interest, coupled with the probability of a profit on bills bought at a low price, induces foreign bankers to invest in London bills. To trace the operation to its conclusion—dear money meant low prices; low prices discouraged imports, because foreign dealers had less inducement to sell their goods in a cheap market; exports were encouraged because bills of exchange on all foreign countries, owing to the previous exercise of arbitrage-dealings, were at a premium for the time, and every export gave the exporter the right to draw a bill of exchange on his foreign customer. Thus the process in brief was: unfavourable Exchanges led to an export of gold, which would reduce the Bank Reserve, and cause the Bank to raise its rate of discount; Market Rate followed or was induced to do so; the foreign bankers invested in foreign bills on London which were at a discount and could be had cheap, and this foreign demand of itself helped to raise the price of the bills; imports tended to fall off and exports were encouraged; and then with every force working to make the Exchanges favourable the crisis and the gold drain quickly passed away. In this manner the Bank of England, by its control over the gold supply of the United Kingdom,

and owing, of course, to the fact that the standard unit of the currency of the Kingdom was the gold sovereign, effectively controlled the Foreign Exchanges.

There was yet another very important power which the Bank was enabled to exercise as a result of these two facts ; and this was the power to prevent an inflation of credit.

When credit expands currency becomes cheap. In the United Kingdom credit is most generally represented by a banking deposit, created as explained, which gives its nominal owner the right to draw cheques and thus convert the deposit into actual currency. An expansion of credit is, therefore, speaking generally, an expansion of bank deposits, and is reflected in the increased amount of cheque currency. When money (the term is not confined to legal tender but to all currency, including cheques) becomes cheap or depreciates, prices in general rise. More money is required, therefore, by the public to pay wages and purchase goods from the retail distributors. The demand falls ultimately, and without very great delay, on the Bank of England, and the ratio of the Reserve of the Banking Department to the liabilities of the Bank falls. This is a sure sign of the expansion that is taking place in the credit currency of the country, and, to prevent it from going too far, the Bank, as a final remedy, raises the discount rate ; then the market, as explained above, follows suit ; money becomes harder to obtain, because dearer, and credit is restricted.

The secret of the controlling power of the Bank

of England over the Foreign Exchanges and the Home Exchange was the dependence of the country on gold, i.e., the fact that the gold standard was effective in the United Kingdom before the war.

Of course the main and primary economic function of Government is exercised in the fiscal administration. It is to this that the term "Public Finance" is applied.

Public Finance is concerned with the management of the State revenue, the supply and application, the getting and spending, of State resources. The need for the existence of State resources is caused by the demands which civilisation makes upon the State. The nature of these demands may be judged from the following main heads under which the items of expenditure of Great Britain and Ireland fell in the years 1913–14 and 1918–19 respectively.

TABLE I *

(£m = millions of pounds Sterling.)

1913–14

		£m
1. War		78
2. Civil and Public Services		40
3. Philanthropic—	£m	
Old Age Pensions	12.5	
Education	19.5	
National Health Insurance	7	
		39
4. National Debt Service		24.5
5. Local Government		10
6. Justice		5
TOTAL EXPENDITURE		£m196.5

* From the White Papers, "Revenue and Expenditure (England, Scotland and Ireland)."

1918–19

	£m	£m
1. War		2,198
2. National Debt Charges		270
3. Civil and Public Services		48.5
4. Philanthropic—		
Old Age Pensions	12	
Education	25·5	
National Health Insurance	7	
		44.5
5. Local Government		9.5
6. Justice		6
TOTAL EXPENDITURE		£m2,576.5

This preliminary view of the workings of the machinery of Great Britain's finances before the war will serve as an introduction; it offers an unfortunately striking contrast to the following account of how the system was affected by the war.

CHAPTER II

1914

THE SHOCK TO CREDIT; CURRENCY MEASURES

(*a*)—The Shock to Credit.

London before the war was the greatest credit centre in the world. It specialised so thoroughly and with such success in the business of making credit that the London Bill of Exchange was used as a recognised means of payment all over the world; and movements of goods between two foreign centres, such as New York and Tokio, were financed by bills drawn in English sterling on London.

The London Accepting Houses held bills for enormous amounts depending for liquidation on the movement of goods and securities all over the world. The function of the Accepting House is to put its credit at the disposal of its customers by accepting bills of exchange as if it were the buyer of the goods or securities whose exchange occasioned the creation of the credit instrument, the Bill of Exchange. Thus, if a commercial firm in London required an advance of funds to purchase silk in Japan, the Accepting House of which it was a client would allow the firm to draw a bill against it, and would accept it by writing the word "accepted" across the face of the bill and appending its signature. The bill would then go

to the merchant in Japan, and he, in due course, would claim payment from the Accepting House, which in turn would obtain payment, plus commission for its share in the transaction, from the original drawer of the bill, the London firm.

Closely connected with the Accepting Houses there are the Discount Houses, whose business is to buy bills and hold them till they mature. Their profit is the difference between the price they pay for an immature bill and the cash they get when the bill matures. The Bill-Brokers do similar business on a smaller scale.

All three—Accepting Houses, Discount Houses, and Bill-Brokers—were continually borrowing on Stock Exchange securities from the large joint-stock banks, with the result that the banks came to be the holders of a large quantity of Stock Exchange paper. The banks also purchased bills from the brokers, and in this way dealt directly in foreign trade, which is not one of a bank's proper functions. The practice is, nevertheless, maintained, as it affords the banks a convenient means of investing idle funds at short notice of withdrawal.

The operations of these various credit institutions depend on transactions in goods, out of which the need for their existence arises. Their function is to facilitate the carrying on of trade, to place the services of credit at the disposal of industry. Any derangement of industry would, therefore, by interrupting the liquidation of credit, be ruinous to them.

The banks themselves depended ultimately on

the Bank of England, and in a crisis would look to it for help. Thus the immense credit structure of England could at any time have been thrown to the ground if transactions in goods ceased, even for a while, and if, coincidently with such cessation of industry, the Bank of England hoisted the white flag.

The narration of how London felt the shock which the dislocation of industry consequent on the declaration of war caused to finance, and of how she recovered from the first effects of it, is not the least thrilling portion of the history of the war ; the after-effects of some of the measures taken are, however, anything but thrilling. The chief lesson taught, if I may anticipate the narrative, is the danger to a country with a thoroughly efficient financial system, if the politicians, with no very intimate knowledge of finance, are permitted to meddle with it. The Bank of England controlled the finances of the Kingdom up to 1914. In 1914 the Treasury undertook to carry out this control, apparently under the impression that it alone was capable of "directing the whirlwind and riding the storm." In the event it proved to be merely the case of a beggar placed upon horseback. Unfortunately it was easier to allow him mount, as we now see, than it is to get him out of the saddle.

The assassination of the Archduke Francis Ferdinand, at Sarajevo, on the 28th June, 1914, is the starting point of the war. As far back as the Spring of 1913 the Continental Bourses had been registering the uneasy state of the political

world ; and now, on the first sign of what at that time appeared to be a mere local difficulty—at worst an occasion for strife between Austria and Serbia —the Stock Exchanges were flooded with selling orders.

On July 23rd Serbia received the Austrian ultimatum, and by this date the Bourses were in a state of panic. On July 27th, the day before the declaration of war by Austria on Serbia, the Exchanges at Vienna, Budapest, Brussels and Antwerp were closed. On July 30th (Thursday) the only Exchanges open were those at London, New York and Paris ; and on the following morning all three were closed. To follow out the course of events leading to the final embroglio : On Saturday, August 1st, Germany declared war on Russia, and poured troops into Luxemburg ; on Monday, August 3rd, Germany demanded a free passage through Belgium, and, on the Belgian King's refusal, proceeded to force her way through ; on August 4th Great Britain declared war on Germany.

The London Stock Exchange had been closed on July 31st. The proximate cause of the closure was the failure of the firm of Messrs. Derenburg and Co., which had many foreign connexions. Their foreign debtors were unable to meet their obligations as they were becoming due, and on Thursday, 30th July, Derenburg and Co. fell under the hammer. On the day before seven less important firms had failed. That it was necessary to close the Stock Exchange it is impossible to deny. The failure of such firms in London would

mean that many more depending on them would need to follow their example, and the infection would very soon have spread throughout the whole credit system. Even the banks would have been most seriously affected had the Stock Exchange been allowed to remain open very much longer.

But the closing of the Stock Exchange, if it removed certain difficulties, created fresh problems demanding immediate solution. All stocks were now unsaleable. The Accepting Houses were the first to feel the blow. They had already been paralysed by the inability of their foreign debtors to meet maturing bills; their stock of bills was an unliquid asset; now their investments became frozen, and ruin faced them. The Discount Houses and Bill-Brokers were also badly hit. To make matters worse, when the banks opened on Saturday, August 1st, they at once began calling in the short loans they had advanced to the Bill-Brokers and Discount Houses, and thus drove their unfortunate debtors to the Bank of England to try to obtain accommodation there, with the result that under the pressure Bank Rate jumped to panic rate, 10 per cent. Then came the week-end and the Bank Holiday on the first Monday in August.

Pausing here, let us survey the state to which the finances of Great Britain were reduced by the declaration of war on Germany and her ally.

Private individuals were affected in two different ways, according as they were creditors or debtors of the banks. If creditors, they were entitled to

withdraw their deposits at short notice; and if there arose any panicky "run" on the banks, the demand could not have been met. There was a danger of such a run to be feared, and this was one difficulty which had to be faced and solved without delay. As debtors, if the security for the loan was stock-exchange paper, the fact that stocks had depreciated so rapidly, and were unsaleable at any price, would have caused the banks to call for collateral security in order to protect themselves, and thus the debtors would be placed in an awkward position.

The Bill-Brokers, Discount Houses, and Accepting Houses were, however, the greatest sufferers. Owing to the stoppage of the machinery of the Foreign Exchanges and the closing of the London Stock Exchange, these firms found themselves in the unfortunate position that they were creditors to a great extent of foreigners who could not remit funds to meet their debts, while they were debtors to the English joint-stock banks which hurriedly, on the first sign of danger, began calling in their loans.

We are at Friday, the 31st July: the Stock Exchange is closed and the banks are open. The natural thing to fear is a run by depositors on the banks. This fear took possession of the joint-stock banks, and they, not being directed by any central guiding hand, acted individually and selfishly, watching only their own interests. A glance at any bank's balance sheet will show the *reason* of the banks' hasty action. I take at random that of the "National Provincial and

Union Bank of England, Ltd.," Balance Sheet, as at 31st December, 1919, published in the advertisement columns of the *Economist*, 7th February, 1920 :—

Liabilities of Bank.	£	Assets of Bank.	£
Capital . .	8,000,000	Cash at Bank of England and on hand . .	35,500,000
Reserve . .	7,000,000	Money at call and short notice .	11,000,000
Current and Deposit Accounts	252,000,000	Investments .	53,500,000
Acceptances .	6,000,000	Acceptances (liability of customers) . .	6,000,000
Profit and Loss Account . .	500,000	Bills Discounted	24,000,000
		Loans and Advances . .	140,500,000
		Bank premises .	3,000,000
	£273,500,000		£273,500,000

It will be seen that the liability on deposits is £252,000,000. Against this the only assets which in time of a credit crisis could be relied upon to remain liquid are cash £35,500,000 and money at call £11,000,000 (doubtful if all could be got in at short notice in a crisis). This totals £46,500,000 ; and even supposing all the advances to customers could at short notice be recalled (which is in fact impossible), the total of £187,000,000 would still fall short of the liability on deposits by £65,000,000 ; and this large deficiency in the case of one bank only.

There was, therefore, an excuse if, on this particular Friday, the joint-stock banks made the mistake of meeting demands for withdrawals

by paying only 10 per cent. in gold and 90 per cent. in Bank of England notes. The public were instructed that if they wanted gold they must go to the Bank of England and cash the notes. Since many people did want gold for the holidays, and many were infected with the very natural fear of a shortage of cash "to go round," a queue formed outside the door of the Bank of England. Inside the Bank, gold was being handed over the counter on demand without demur, and bills were being discounted for the Bill-Brokers as fast as possible. But the strain of withdrawals forced the Bank Rate up to 8 per cent. on Friday, and to 10 per cent. on Saturday. In previous crises, since 1844, the 10 per cent. Bank Rate was the distress signal of British finance, a direct invitation to the Chancellor of the Exchequer to promise the usual indemnity against prosecution for violating the Bank Charter Act. However, Saturday was a half-day and Monday a Bank Holiday, and during the breathing-space the Chancellor and the banks met to discuss the situation. The following measures were at once taken :—

(*a*) Three extra Bank Holidays—Tuesday, Wednesday and Thursday—were declared. This was to protect the banks against a run by the depositors until such time as emergency currency was available.

(*b*) On August 2nd a Moratorium for one month, to the 4th September, applying to bills of exchange accepted before August 4th, was proclaimed, and the Proclamation was legalised on August 3rd by the Postponement of Payments Act

(4 and 5 Geo. V). A measure was also passed empowering the courts to stay proceedings brought by a creditor against his debtor to recover moneys due to him.*

(*c*) On August 6th the Moratorium was extended to all negotiable instruments and to all payments of any kind except those expressly exempted in the Proclamation.

(*d*) A further Proclamation on August 12th, extended the provisions of the Proclamation of August 6th, so as to cover payments in respect of any debt from any bank whose principal place of business was in any part of His Majesty's Dominions.

To follow out these precautionary measures :—

(*e*) On September 3rd, 1914, the Moratorium was extended for a further month, to October 4th, and on the 30th September it was further extended to October 19th.

These various Moratoria were proclaimed chiefly at the earnest request of the bankers, and were an effective preventive to a " run " on the banks. The Moratorium of August 2nd postponed the failure of the Discount and Accepting Houses, but on October 19th such failure would have come just the same, unless indeed their foreign debtors were in a position to liquidate their overdue debts by that time. To prevent the panic which would have resulted from the ruin of these credit-houses, the Government of the day took a bold step, unprecedented in the history of British finance. It is to be realised that what the

* Courts (Emergency Powers) Act, 1914 (4 & 5 Geo. V).

Accepting Houses wanted was a market in which they might be able to sell their bills. The breakdown in the Foreign Exchanges had rendered these bills unsaleable, and had likewise locked up the bankers' and brokers' funds invested therein. The Government now provided a discount market as follows. On August 13th it was announced that the Bank of England would discount all approved bills of exchange, which had been accepted before August 4th, without recourse against the holders, and that the Government had guaranteed the Bank against any loss it might suffer on the transaction. Under this guarantee the Bank bought all bills which were presented to it, even of the sort which in normal times it would not have touched.

Accepting Houses, Discount Houses and Bill-Brokers were, by this arrangement, enabled to get rid of their frozen bills, and with the proceeds pay off their loans from the joint-stock banks. This put the banks in a strong position, while freeing the foreign credit-houses from anxiety; but it did not enable the latter to engage in any fresh dealings, and the blame was laid at the doors of the joint-stock banks, whose short loan fund was liquidated, but who made no fresh use of it. In fact the banks seemed again to be adopting a short-sighted policy, and to be merely taking advantage of the help they had got from the Government to strengthen their own position in case matters grew worse. So foreign trade was almost at a standstill. To help the Accepting Houses to commence business again, when it was

seen that the first step was not sufficient, the Government did not hesitate to take a further measure. On September 5th is was announced that the Bank of England, instead of merely purchasing pre-moratorium bills, was prepared to lend money to the acceptors to enable them to meet the bills, interest being charged at 2 per cent. above Bank Rate; and a promise was given that repayment would not be demanded until twelve months after the termination of the war. This arrangement relieved the endorsers of those bills which the Bank had previously bought from the holders, and the Accepting Houses were thus put in a position to start their business again with the credit of the nation behind them.

On the 19th October the Moratoria came to an end, and the financial crisis of the war may be said to have likewise ended. From this on there is an abnormal normality about the finances. The sudden jumps and changes almost cease, and there is a war-time, business-as-usual, level reached, which, if it changes, does so gradually and imperceptibly.

The Government had saved the situation in the world of finance, when selfish interests (such as those of the banks) might have ruined the country. The Government has been accused of having gone too far in its interference, and of pledging the nation's credit for the benefit of individual credit-houses. It is easy to judge after the event, and the accusation is justified to a very great extent. But it cannot be denied that the error was on the right side; and the Chancellor who

was responsible for the steps taken is not to be blamed if, ignorant himself of the workings of finance, he too readily accepted the suggestions, often selfish and short-sighted, of the various financial interests. The main thing is that the great and sudden crisis caused by the dislocation of trade was successfully tided over, and a period of normality reached. The Bank of England rose to the occasion, as British financiers always had trusted it would, and appeared more than ever in the guise of a State Bank, with all the advantages of such an institution and none of the very great disadvantages which stood out so clearly in the case of the Banque de France in the Franco-Prussian War.

(*b*)—Currency Measures.

I have purposely omitted from the preceding account mention of the measures taken by the Government to provide emergency currency during the crisis. These are contained in the Currency and Bank Notes Act, 1914 (4 & 5 Geo. V), passed 6th August, 1914, the terms of which briefly amount to (*a*) empowering the Treasury to issue £1 and 10*s*. Currency Notes to be legal tender in payment of any amount, and (*b*) authorising all Banks of Issue to issue notes in excess of any limit fixed by statute. By this measure, the monetary and fiscal functions of the State were confused for the first time in the modern history of the country, and all check on the Government's power of issuing more currency

than was required by the demands of industry was removed; also that part of the 1844 Act which limits the note issue of the Bank of England was suspended, and its future suspension was left to the discretion of the Bank and the Treasury, without the necessity of obtaining Parliamentary sanction.

What was the need that occasioned these measures? There had been a slight run on the banks by the public on the Friday and Saturday preceding the first Monday in August; apparently just such a demand as the general holiday would, in the ordinary course of events, have caused. But the banks had, as we have seen, paid only 10 per cent. of the demand in gold and 90 per cent. in Bank of England notes, with the result that those who required gold had to go to the Bank of England and wait their turn to cash the notes. This shortsighted policy of the banks caused some fear of a panic. But the Bank of England allayed this by paying in gold all demands made on it; and on Saturday it had lost £18,262,500 in gold, partly to the Continent, partly to the banks, and partly to the people who brought notes to cash. The banks did not open again until the following Friday, August 7th, i.e., the day after the Currency Bill had become law, and according to the *Economist* (August 8th, 1914), "When the banks opened their doors again on Friday the public showed very little agitation, and the general impression was that preparations made by the banks were even over-cautious."

Firstly, why was the Bank Act suspended,

and was its suspension necessary? Under the Act of 1844, the Bank of England is allowed to issue notes to an amount that was fixed at £m14 and which, owing to a provision in the Act empowering the Bank to take over two-thirds of the note-issuing power of any other note-issuing bank that might cease to issue notes, had risen to £18,450,000. Beyond this limit the Bank can issue notes only against a cover of gold i.e., for every £5 note issued there must be gold to this amount in the Issue Department. By the suspension of the Act is meant generally the suspension of this note-limiting clause. Thus when the Act is suspended the Bank is empowered to issue notes over and above the limit of £18,450,000, against, as a rule, Government securities taken from the Banking Department and placed in the Issue Department. It was always necessary to obtain the promise of the Prime Minister to have introduced in Parliament a Bill of Indemnity for the violation of the Act before its suspension actually took place. Thrice since 1844 this procedure of breaking the law and obtaining an indemnity against the consequences had occurred, and authorities on British banking were fairly unanimous in advising a change to a more automatic and at any rate a less illegal method of enabling the Bank to increase its note-issue in time of crisis. But the system, or want of system, worked, and so was satisfactory.

The main reason for suspending the Act is to allay a fear amongst the public that there will be a shortage of money owing to hoarding caused

by some financial catastrophe. The debacle of August, 1914, was taken by the authorities to be a certain cause for such a fear. This explains why at once people and Press prophesied the suspension, and why it did take place. It was a correct thing to do no doubt, and it hurt nobody. The most interesting thing about it is that, as in 1847 and in 1866, it proved to be necessary merely as a panic-allayer and not as an actual means of increasing the currency; but this may perhaps be explained by the action of the Government in taking unto itself the power of issuing paper money without legal limitation to the amount issued. At any rate, between July 22nd and September 2nd, 1914, the increase in the circulation of the Bank of England was only £10,625,000 and against this a deposit of gold to the same amount was made in the Issue Department; so that the licence granted to the Bank by the Currency and Bank Notes Act, 1914, was not availed of.

Regarding the Currency Note issue of the Treasury, it may be remarked, first, that in the United Kingdom the most generally used form of currency is the cheque. In time of crisis, when credit is shaken, the cheque is not an acceptable means of payment, as it is essentially a credit creation. The idea in having an emergency paper currency is to tide over the crisis until credit is restored, and the cheque can again be used as a counter for making exchanges. It was, therefore, only natural to assume that in England, when the credit of the country was

shaken by the first thunderclap of war, a need would arise for such an emergency currency, so it is unfair to blame the Government for taking precautions. The fact was overlooked, however, that the chief trouble in the financial world was not so much a shaking of domestic faith or credit as a loss of faith in the promises of foreigners. Set right the Foreign Exchanges, or as this was impossible, since foreign countries could not co-operate, create a market for the foreign bills of the foreign credit-houses, and the Home Exchange would have taken care of itself. Of course the shaken credit in foreign bills was sure to affect the credit to be placed in firms and individuals who had dealings with foreigners; and in this manner, if these firms had been left to look after themselves, and had not been helped out of their difficulties by the Government, the whole credit system of the Kingdom would have felt the shock. But the Government did assist in rehabilitating the foreign credit firms, and did make their assets liquid by creating a market in the Bank of England for bills which would otherwise have remained locked in the portfolios of the holders; and in doing this the Government did all that was necessary in the way of helping both Foreign and Domestic Exchanges. The actual fact is that there was no panic in the Kingdom, and no rush for currency, and very little hoarding on the part of the public. This is, I imagine, to be explained by the confidence the British people have in their financial system. However, supposing there was a need for big issues of an emergency paper

currency, the power should have been given, not to the Treasury, but to the Bank of England. In solving the credit difficulty the Government had already placed unprecedented confidence in the Bank of England, and had merely guaranteed it against loss arising from the help it gave to the public. But now, after suspending the Bank Act, it proceeded to give to its own Treasury the power to issue a paper currency. This was a big departure in principle from the tradition of the past; and though in itself it was not equivalent to abolishing the gold standard, it proved in the event to be the means by which the gold standard was eventually superseded.

Had the Currency Notes been withdrawn in September, 1914—the *Economist* of 19th September, 1914, advised their withdrawal—or had they merely been issued up to an amount to fill the place of hoarded gold or of gold subsequently returned to the Bank through motives of patriotism, the gold standard would still have been effective, even though no gold actually appeared in circulation. But they were in fact issued in ever increasing amounts, and clearly in excessive amounts.

On the 27th August, 1914, a memorandum was issued by the Treasury which explains the manner in which the notes were obtainable by the banks. They were to be issued by the Treasury through the Bank of England to bankers, as and when required, up to a maximum limit not exceeding 20 per cent. of their liabilities on deposit and current accounts; and the amount of notes issued to each bank was to be treated

as an advance bearing interest at current Bank Rate. The total deposits of the banks of the United Kingdom on the 31st December, 1913, was £m1,077 (*Economist*, 23rd May, 1914), and 20 per cent. of this is £m215, whilst the amount of gold in circulation in July, 1914, is estimated at about £m80. Clearly the Government was taking care that there should be enough currency to go round!

The method by which the Government financed the war will be explained later; here, suffice it to say that this method necessitated the creation of large Government credits at the Bank of England, which were quickly depleted by the payments made by the Government to contractors and others, and as quickly returned to the Bank of England, appearing in the Bank's return under the head of "Other Deposits." The Government then created fresh credits, and these eventually returned to the "Other Deposits" of the Banking Department. Thus the deposit and current accounts of the joint-stock banks were rapidly increasing, and the deposits in the Bank of England, being the balances kept there by the joint-stock banks, were also increasing. The banks could obtain Treasury Notes by transferring cash from their balances at the Bank of England to the credit of the Currency Notes account, and they were thus enabled to purchase the notes outright, and did not need to pay interest at Bank Rate. By this means a vicious circle was created: the Government found it necessary to create fresh credits at the Bank, and to pay

away large sums to its employees and others, and the greater part of these sums was lodged in the joint-stock banks; so that the banks were put in a position to increase their balances at the Bank of England at will, and with these balances they could purchase currency. There was no check, therefore, on the note issue, and the Bank of England was powerless. A reference to what I have written in Chapter I, on the manner in which the Bank of England prevented an undue expansion of credit, will explain why the Bank was unable to perform this useful function during the war. In pre-war time the Bank Reserve would have been threatened if the joint-stock banks had converted their balances to any large extent into notes or gold; and the Reserve being threatened, the Bank would have taken the usual measures to check the credit expansion. But now the notes could be had *ad libitum*. There was no gold standard to hold them down to a fixed limit or ratio; they were printed and issued by the Treasury, and could, without expense, be purchased in big amounts, owing to the expanded deposits of the joint-stock banks.

That the policy of giving the Treasury power to print and issue Currency Notes was wrong, we might almost say wicked, events have proved. For when the crisis passed, and all need for an emergency currency ceased to exist, the Government still retained its power to issue currency, and the printing press was used more frequently as the war went on. The *systole diastole* of the guillotine marked the progress of a political

revolution in a neighbouring country; the throbbing of the Currency Note printing machine marked the stages of a financial revolution in England. The Treasury's power of printing and issuing Currency Notes was used as a fiscal device for getting a loan without having to pay interest for it; these notes were, in the result, the means of confusing, in a most shameless and unprecedented fashion, the monetary and fiscal functions of the State.

CHAPTER III

PUBLIC FINANCE IN WAR-TIME : 1914–1920

The State needs money. This is but a way of saying that the work of men's hands and brains is needed if a Government is to perform its functions. Even the smallest unit of Government, the family, entails labour, to enable it to exist ; and it was in an effort to reduce to an art the management of this primary unit of Government that the science, with a section of which we are dealing, came into being.

To say, therefore, that a State needs money is to state an enthymeme, of which the really important and often-overlooked term is, that money gives power to control men's labour. The complete syllogism ought to read : men's labour is needed by the State, particularly in war-time ; money represents men's labour ; therefore the State needs money—especially when it has a big war on hands. Had the Governments of the various belligerent nations been brave enough to face this rather elementary logic, they would soon have recognised the evils of trying to obtain labour-energy by multiplying the counters of money ; and they would, as they ought all have done, have gone straight to the pockets of the people and taken out whatever money was needed to finance the war.

Time was when the State insisted on obtaining from its subjects actual labour-service. Of this nature was the *corvée* in France, for example. In theory the State still has the power to conscript wealth, and the labour that is an essential factor in the production of wealth, just as it conscripts the very source of labour when it enrols in its armies the able-bodied males among its subjects. But industrial conscription is a big problem and, as it was not resorted to in the United Kingdom during the recent war, it is not my intention to dwell upon its possibilities here.

Money is, by virtue of its function as a measure of value, a crystallised form of labour. It would be ridiculous, of course, to call money labour, but it represents a claim by the possessor on the community wherein the money is current to demand labour or its fruits. If, therefore, a State can get money, it does not need to directly conscript those who are capable and willing to use their muscles and their intelligence in the production of goods; for it can, by paying for their services, secure the same result in a much simpler manner. Three ways are open to a State to obtain revenue: (*a*) taxation, (*b*) loans, (*c*) currency manufacture. Much has been written on the advisability of the use of each of these three methods; it is, however, sufficient to remark that the last is, as a means of obtaining revenue, always bad, and resort to it is a sign of either a weak system of finance, or a weak body of financiers; the second is a resource whenever taxation for any reason cannot well be employed;

while the ideal method, whether for an individual, a family, a society, corporation or State, the straightest, cleanest, and most direct and honest method of paying one's expenses is that which I have called taxation, furnished by the excess of goods produced over goods consumed.

Professor Bastable lays down the following four rules as to the methods by which a State should obtain its revenue :—

(1) " Expenditure should, as far as possible, be met out of the annual receipts, and, therefore, increased outlay should be balanced by heavier taxation.

(2) " In the case of a non-recurrent expense of a large amount a loan is preferable to a dislocation of the tax-system.

(3) " When the abnormal expenditure extends over a series of years, the various forms of taxation should be adjusted to meet it.

(4) " This general principle, however, fails where either (*a*) it would be impossible to secure an equitable division of the heavy taxation necessary ; (*b*) the limit of productiveness with regard to the several taxes would have to be exceeded ; (*c*) for political reasons it is inexpedient to press heavily on the tax-payer. Under any of these circumstances, resort to loans, as a supplement to the tax revenue, even for a somewhat lengthened period, is defensible."

As one would expect, the method of paying for expenses by debasing the currency, or inflating it, which is the same thing, is not even mentioned.

The difference between the two methods, of taxation and of borrowing, is that taxes are amounts of purchasing power over goods handed to the State by the people, and without any liability on the part of the State to repay them; whereas loans to the State resemble loans made to a corporation or private individual, and carry with them liabilities of repayment, and (usually) of payment of interest while the principal is outstanding.

Let us first glance at the revenue and expenditure accounts of the United Kingdom as they were before the war.* In the financial year 1912–13 the State expenditure of the United Kingdom was £m189, and the revenue was £m189, there being a slight surplus of revenue over expenditure amounting to £180,000. In 1913–14 the expenditure was £m197 and the revenue £m198, the surplus being about £800,000.

Thus, in pre-war years, the entire State expenditure of Great Britain and Ireland was met out of revenue; and included in the expenditure each year was a sum of about £m5 to the "new sinking fund" towards extinction of the National Debt. In 1912–13 the total National Debt was £m716,† and in 1913–14 £m707, and had been gradually falling since 1903, when it stood at £m798.

Before entering on the finances of the war

* For all years up to and including the year 1918–19, the figures are taken from the Returns, "Revenue and Expenditure (England, Scotland and Ireland)," but for the year 1919–20 from the Return "Public Income and Expenditure" (Cd. 73, 1920), the other return not being available at time of writing.

† Figures of National Debt are taken from the annual Government returns, entitled "National Debt."

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period, I should point out that the British national debt originated in 1689 with the Revolution which placed William III on the throne. It stood at £664,263 in 1672. In 1920 (at 31st March) the total dead-weight debt was £7,882,000,000. The increase has been due solely and entirely to the costs of war, as will be readily seen from Table II on opposite page.

Coming to the war finances, Table III (on p. 41) shows the Revenue and Expenditure of the United Kingdom in each of the seven years ended 31st March, 1920.

Table IV states the amount of the National Debt * at the 31st March of each of the same seven years.

TABLE IV

(Total Debt, in millions of pounds Sterling.)

At 31st March	£m
1913	716
1914	707.5
1915	1,165
1916	2,197
1917	4,064
1918	5,921
1919	7,481
1920	7,882

Examining the revenue side of the account (p. 41) it is noticeable that direct taxes, which in 1913–14 yielded £m87, in 1918–19 yielded £m623, the percentages of total revenue being 44 per cent. for 1913–14, and 70 per cent. for 1918–19; while

* From "National Debt," 1920, White Paper, Cmd. 429.

Table II

Date	Debt		
	£		
1689	664,000	Revolution—Parliament obtained financial control.	£
1697	21,515,000	War of League of Augsburg added . .	20,851,000— 8 years
1702	16,394,000	Peace reduced debt by	5,121,000— 5 years
1713	52,145,000	War of Spanish Succession added . .	35,751,000—11 years
1739	47,954,000	Peace reduced debt by	4,190,000—26 years
1748	79,293 000	War of Jenkins' Ears added . . .	31 339,000— 9 years
1756	74,332,000	Peace reduced debt by	4,961,000— 8 years
1763	138,865,000	Seven Years' War added	64,533,000— 7 years
1775	128,584,000	Peace reduced debt by	10,281,000—12 years
1783	249,851,000	American War added	121,267,000— 8 years
1793	244,118,000	Peace reduced debt by	5,733,000—10 years
1816	885,000,000	Napoleonic Wars added	640,882,000—23 years
1854	803,000,000	Peace reduced debt by	82,000,000—38 years
1857	836,000,000	Crimean War added	33,000,000— 3 years
1899	635,000,000	Peace reduced debt by	201,000,000—42 years
1903	798,000,000	Boer War added	163,000,000— 4 years
1914	706,000,000	Peace reduced debt by	92,000,000—11 years
1919	7,481,000,000	War 1914–1918 added	6,775,000,000— 4 years

From Chapter II, Part II, of *The Political Economy of War*, F. W. Hirst (1915), and from "National Debt" Return (1920), Cmd. 429.

the indirect taxes yielded £m75.5 or 38 per cent. in 1913–14, and £m163.5 or only 18 per cent. in 1918–19. If the net revenue is reduced by the expenses, charged under expenditure, of the Post Office, the percentages read: direct, 1913–14, 54 per cent., 1918–19, 80 per cent.* It is wholesome to see the direct taxes increase at a faster rate than the indirect, for direct taxation is more equitable and less injurious to industry. The most important direct taxes in the British fiscal system, as developed during the war, are the Income Tax (including the Super-tax) and the Excess Profits Tax. The Income Tax yielded £m47 in 1913–14, being 30 per cent. of the total revenue from taxes; in 1914–15 £m69.5, i.e., 36 per cent.; in 1915–16 £m128—44 per cent.; in 1916–17 £m206—40 per cent. (on account of the Excess Profits Duty which swelled the gross revenue); in 1917–18 £m238, being 40 per cent.; in 1918–19 £m293 or 37 per cent.; and £m359 or 36 per cent in 1919–20. £m359 is a very big return from the Income Tax, the total 1913–14 revenue being only £m198.

In the first year of war, 1914-15, the rate of taxation was left at the 1913–14 figure of 1*s.* 2*d.* in

* For 1919–20 the percentages are:—Direct, 56 per cent., Indirect, 44 per cent., taking net revenue. The revenue from miscellaneous sources, amounting to £m281, has been included with the indirect taxes. Properly this is not revenue at all, being for 1919 comprised of the proceeds of the sales of raw materials (£m69 each from the Ministry of Munitions and the Wheat Commission, £m56 from the Ministry of Shipping, £m25 from the Ministry of Food), and it includes also a sum of over £m13 on account of "contributions towards the expenses of the war," of which £m10½ were from the Government of India. These windfalls should have been used towards reducing the troublesome floating debt, and not as a pretence at balancing the accounts.

TABLE III—REVENUE

	1913-14	1914-15	1915-16	1916-17	1917-18	1918-19	1919-20
	£m	£m	£m	£m	£m	£m	£m
Income Tax	47	69.5	128	206	238	293	359
Excess Profits Duty	—	—	—	142	223	284	290
Customs	35.5	39	59.5	71	71	103.5	149
Excise	40	42,5	61	56	38.5	60	134
Estate Duties	27	28.5	31	31	31.5	31	41
Stamps	10	7.5	6.5	7.5	8.5	12.5	23
Land Tax and Inhabited House Duty and Land Values	3	3	3	3	3	3	3
Post Office	31	30	34	34	35	40	44
Crown Lands and Dividends	2	1.5	3	8.5	7	12.5	16
Miscellaneous	2	6	10	16.5	52	52	281
TOTAL	197.5	227.5	336	575.5	707.5	891.5	1,340
		EXPENDITURE (EXCHEQUER ISSUES)					
Nat. Debt Charges	24.5	22.5	60	127	190	270	332
Army	28.5	29	—	—	—	—	448*
Navy	49	51.5	—	—	—	—	157
Civil Government	66.5	69.5	68	66	72	79	585
Post Office and Inland Revenue	29	30.5	31	31	31	32	57
Votes of Credit	—	357	1,400	1,974	2,403	2,198	87
TOTAL	197.5	560	1,559	2,198	2,696	2,579	1,666
Surplus	—	—	—	—	—	—	—
Deficit	—	332.5	1,223	1,622.5	1,988.5	1,687.5	326

* Air Force included.

The figures for the years 1913–14 to 1918–19 (inclusive) are taken from the White Papers, "Revenue and Expenditure (England, Scotland and Ireland)"; but the 1919–20 figures are from the return entitled "Public Income and Expenditure" (Cmd. 73, 1920), the "Revenue Expenditure" paper for this year not being available in October, 1920. These figures are subject to correction when this return is published.

the pound ; but in the Autumn of 1914, a second or supplemental Finance Bill was introduced, and passed into law, raising the rate to 1*s.* 8*d.* ; it jumped to 3*s.* in the following year, and to 5*s.* in 1916–17. It was left at this rate in the year 1917–18, but in 1918–19 it was increased by 1*s.* to 6*s.*, at which figure it has since remained.

Included in the return of Income Tax revenue is the revenue from the Super-tax. This, in 1913–14, was charged on the excess of income above £3,000 in the case of incomes exceeding £5,000 per annum. By 1919–20 the limits had been reduced, so that the excess over £2,000 was chargeable if the total annual income exceeded £2,500. The rates vary from 1*s.* in the pound on the first £500 of the excess to 4*s.* 6*d.* in the pound on the excess of the annual income above £10,000. The Super-tax is really an extension of the Income Tax and is not distinguishable from it.

The Excess Profits Duty was first imposed by the Finance (No. 2) Act, 1915 (Sec. 38, *et seq.*). This tax is not yearly, like the Income and Super Taxes, but is based on the profits of accounting periods of three, six, or twelve months, and is levied accordingly. Broadly, the basis of assessment is the excess of the profits made during the accounting period, less an allowance of £200 per annum, over a standard profit of a corresponding pre-war period. This standard is the average of the profits of the best two of the last three trade years ended before the 4th August, 1914 (Sec. 40 (2)) ; except in cases where abnormal depression in any particular industry may have

caused the profits of these years to be abnormally low, in which case the average profits of the best four of the six preceding years are taken as the pre-war standard. The Excess Profits Tax does not apply to (*a*) husbandry, (*b*) offices or employments, (*c*) any profession the profits of which are dependent mainly on the personal exertions and qualifications of the person carrying on the profession, and in which no capital, or only a very small amount of capital, is required to have been sunk. In arriving at the profits of any accounting period, for excess profits purposes, allowance is made for increased capital put into the business. It will be seen that this impost is intended to fall on war profits; that is to say, on profits accruing to a person on account of and by reason of the war rather than as the result of exceptional personal ability, or as a return from increased capital. The percentage of the excess profits passing to the State was:—

(1) Fifty per cent. of the excess for one year, from the commencement of the first accounting period;

(2) Sixty per cent. of the excess after the expiration of that year and before the 1st January, 1917;

(3) Eighty per cent. of the excess from the 1st January, 1917, to 31st December, 1918;

(4) Forty per cent. of the excess from the 1st January, 1919, to 31st December, 1919;

(5) Fifty per cent. of the excess from the 1st January, 1920.

The Munitions of War Act, 1915, with the

Munitions (Limitation of Profits) Rules, 1915, are the authority under which the Minister of Munitions was empowered to place under control works engaged in the manufacture of munitions of war, and these Acts provide that, in the case of such controlled businesses, the profits made in excess of six-fifths of a standard pre-war profit were to pass to the Treasury. This is an extension of the principle underlying the Excess Profits Tax; and the revenue from this source is included in that from the Excess Profits Tax.

Returning to our table, it will be seen that the Excess Profits Duty yielded £m142 in 1916–17, £m223 in 1917–18, £m284 in 1918–19, and £m290 in 1919–20. The reason why the duty is not returned for 1914–15 or 1915–16 is that the tax payable in respect of these years was not collected and paid to the account of the revenue till the fiscal year commencing 6th April, 1916; and, owing to the fact that each fiscal year is credited only with the tax actually paid into the Exchequer in that year, and not with arrears of tax paid on account of that year, in some subsequent fiscal year, the years 1914–15 and 1915–16 show no revenue from the Excess Profits Duty. It is indeed fortunate for the statistician that this rule, of closing each year when it ends, and not including any possible arrears of tax which may be paid later, exists; otherwise the figures could not be taken as finally corrected, until, at the very least, three years after the end of the fiscal year to which the returns relate.

The only other item in the revenue returns

claiming notice is the "income from miscellaneous sources." This is a war novelty, and has never been fully explained or detailed. It shows a rapid increase in the later years of the period. It is in reality (generally speaking) the profits (or profiteerings) of the Government on sales of wool, sugar, etc., purchased early in the war and released at controlled prices to the wholesale dealers. The large amount in 1919–20 is the result of sales of war-materials, army clothing, etc.

It is unnecessary to examine in detail the expenditure side of the accounts. The votes of credit are the chief contributory items, and the increased charge of the National Debt service is noticeable, but hardly surprising.

Adding together the revenue for the five years and the expenditure during the five years from the beginning of 1914–15 to the end of 1918–19, we find that the expenditure is £m9,592 and the revenue £m2,737.5. Thus the percentage of expenditure met by revenue is 28½ per cent., and the balance, 71½ per cent., must have been borrowed.

When a Government borrows, it has the option (though not always of course) of borrowing from its own people or from foreigners. In either case it obtains immediate purchasing power over goods in return for a mortgage which it gives to the lender on the future resources of the State. Yet there is a big difference in the effects caused by the two kinds of borrowing. In the case of internal loans, the community lends its purchasing power, or money, to the State; and if the

lenders work harder, and save more, and spend less in extravagant and luxurious consumption, the loan resembles taxation, by the manner in which the purchasing power of the people is restricted at the expense of the increased purchasing power given to the State; and it is, of course, more advantageous to the lenders than taxation would be, for it gives them a claim on the State resources which taxation does not. The war brought home to people's minds the vast amount of things which can be done without. It made us understand clearly how easily our wants, when satisfied, lead us on to desire the satisfaction of other wants and so on without ending. The subsistence line is indeed low down and well submerged in the satisfactions which we ask of and are given by modern productive effort. If people, in time of war, stinted themselves in luxuries, pruned their expenditure, and confined their attention to the mere satisfaction of their primary needs, there would be, I venture to say, no such thing as economic exhaustion. If the world were peopled with Trappist monks,—but then, I suppose, wars would cease; that is, provided the rule of perpetual silence was rigorously observed! However, it is to be noted that internal loans, as long as they are taken from a genuine excess of production over consumption, are very much to be preferred to foreign loans. Their only disadvantage compared with taxation is that they constitute the basis of a future debt, and therefore affect the future distribution of wealth in the country.

When the Government turns to foreigners for

a loan it is really offering to mortgage to the lenders the future tax revenue of the country. If the loan is spent productively, of course it should pay for itself; and there is on the whole a gain. But if it is spent in munitions of war, in shells and high explosives, which disappear in smoke on the battlefield, then so much wealth has been spent, and there is no apparent return for it; so that the country has been impoverished to the extent of the loan, and the foreigner still must be paid his interest and the capital sum at maturity.

Of the total increase in the National (War) Debt over the pre-war debt (£m7,882 at 31st March, 1920, less £m716 at 31st March, 1913—£m7,166), the amount borrowed abroad is £m1,280, being 18 per cent., roughly. The balance, 82 per cent., is indebtedness on the part of the Government to its own people. (Of course some of the internal loans were subscribed to by foreigners, but the amount is not known and is probably comparatively very small.) Against this, England advanced loans to her Allies in the war, and to the Dominions, the amounts being :

Dominions . .	£m 119.5
Allies . .	£m1,731.0
Total .	£m1,850.5

of which the Russian loan is £m570, leaving £m1,280.5 due; so that the amount borrowed abroad (£m1,280) is cancelled by the amount loaned

abroad, after deducting the doubtful debt of £m570.

The weakest point in the war finances which we have so far discovered is the low proportion of expenditure met out of revenue. Yet it is higher than in the case of either France, Germany, Italy, or Austria. Of course, France was handicapped by having the richest portion of her territory occupied by soldiery, friend as well as foe; and the other countries were at a disadvantage owing to the blockade of their shores by the British Fleet and the consequent cutting off of their foreign trade. On the other hand, England had all the advantages of control of the seas, subject to the submarine danger.

Our investigation, then, has given us the following facts:

Total Expenditure, 1st April, 1914, to 31st March, 1920, £m11,258.

Taxation gave 36 per cent.—Direct 61 per cent., Indirect 39 per cent.*

Borrowing gave 64 per cent.—Internal 82 per cent., Foreign 18 per cent., the foreign loans being cancelled by foreign debts due to Great Britain.

But we have yet to ascertain what were the methods by which the amount borrowed internally was obtained. As stated in the introduction to this paper, there are very many ways of reaching goals in finance; and some, which under certain circumstances are permissible, are very reprehensible under different circumstances.

* Includes £m417.5 "Miscellaneous" Revenue which is 10 per cent. of the entire tax revenue for these six years.

The War debt raised by internal borrowing as it stood on the 31st March, 1920, amounted to £m5,928, made up as follows :—

		£m
1. Three War Loans, Funding Loan, and Victory Bonds		2,882
2. National War Bonds, Exchequer Bonds and War Savings Certificates		2,069
3. Treasury Bills and Ways and Means Advances		1,312
		£m6,263
Deduct 1913 Debt	£m716	
Less present Funded Debt	334	
		382
		£m5,881
Add other Capital liabilities		47
		£m5,928

Let us first take the War Loans, etc. In so far as the £m2,882 represented genuine savings, i.e., excess of capital produced over that consumed, this item calls for no remark ; we have already spoken about a loan of this kind. But it is common knowledge that a great part of the subscriptions to the War Loans represent either money subscribed directly by banks, or money borrowed from banks by individual subscribers to the loans.

When a bank subscribes to a Government loan, it finds its " cash in hands and at Bank of England " lessened by the amount of the subscription and it has in its assets the Government security.

The Government utilises the money so obtained, and (generally speaking) when it returns to public circulation it is lodged in the bank—in some bank—and so increases the bank's deposits on the liability side. Thus taking a broad view of the transaction: if the amount subscribed is £1,000, the final result is—the Government debt is increased by £1,000, and the bank holds a bond for this amount; the banking deposits of the country are up by £1,000. Incidentally it may be remarked that the bank has locked up liquid cash in Government stock to the detriment of its powers of granting the credit facilities which at the end of a war, when the work of industrial reconstruction commences, are so badly needed.

In this process the most obvious thing to notice is the increased banking deposit. It is like a signal—showing that credit has been inflated. But more important in its immediate effects is the increase in the currency necessitated by the new creation of credit. The Government pays its big contractors in cheques. They lodge these cheques in their local banks; but when pay-day for their employees comes, they require cash, and apply to the bank accordingly. The bank then hands out the paper notes marked "legal tender for payment of any amount," and so the currency notes enter into circulation. The method of creating credit to finance the war necessitates the issue of currency notes.

In the case of an individual subscribing money borrowed from a bank, the process is that the

bank's deposits are increased by the amount of the advance made; the Government spends the proceeds of the loan, and the deposits of some bank are increased and drawn upon later for cash; so that the result is the same, except that the bank holds no Government stock, but instead holds the individual's bond as security for the advance. No bank will advance money to a person who has no standing with it in order to enable him to buy industrial stock; nevertheless the banks, acting according to instructions from the British Treasury to the Bank of England, allowed borrowers who wished to subscribe to the War Loans advances to the full value of the bond, at interest 1 per cent. below Bank Rate, the loan not to be pressed for until the end of three years from the date of its creation. People were told it was patriotic duty to borrow from the banks in order to subscribe to the loans; and they did. A further attraction was offered to subscribers by the announcement that the Income Tax payable on the War Loan interest would be charged only on the excess of the amount received over the amount due on the bank overdraft or loan. It was all very well if the borrowing subscribers understood that they were not performing a patriotic duty, but only offering to perform such; and that the work of paying off the bank overdraft out of savings from income was the real duty that they undertook to perform.

I have not any figure of the amount included in the £m2,882 which represents credit which was not at the time of subscription genuine credit,

and which was not made up for later on by saving. But the figures of banking deposits bear testimony to the inflation caused by this method of borrowing. In 1913-14 the total deposits of the United Kingdom, including those of the Bank of England, amounted to £m1,077, and in 1919 to £m2,500, an increase of £m1,423. These figures disclose only part of the increase; they are the amounts of deposits on one day, at the end of the calendar years referred to. But all through the years of war deposits were continually being (to use a phrase of Professor Nicholson) pulverized into cash, and so disappearing.

Borrowing by means of National War Bonds and War Savings Certificates is a method which was not attempted in the early part of the war. It was when the amounts of Treasury Bills outstanding had reached an alarmingly big total that the Bonds were issued to attract the people's earnings; and the War Savings Certificates were later the means, not only of obtaining a large revenue for the State, but of inculcating into the minds of people the necessity for and the advantages of saving. These methods might have been begun earlier and relied upon to a far greater extent than they were. A war debt which is spread amongst the masses of the people possesses after-war advantages, from a social point of view, over a debt which is held by the rich classes. Yet, turning to the third item in the war debt, the Treasury Bills and Ways and Means advances—we see that £m1,312 was obtained by pure, undiluted juggling with credit. The only people

who have an interest in this part of the debt are the professional money dealers in London, who were by far the largest purchasers of Treasury Bills. Before the war, Treasury Bills were created by the Chancellor when he needed to anticipate revenue, and they were repaid in three or six months time. But during the war they were created in such large amounts that the outstanding totals were often over £m1,000.

Ways and Means advances were also used before the war to tide the Government over a low revenue period, but they had to be repaid in the quarter following that in which they were obtained. The Bank of England advanced the funds, and the Treasury paid back as soon as revenue began to come in. But, however much the Chancellor may have desired to avoid straining their use during the war, and however little his anticipation of the use that would have been made of them, he was constrained, owing to his Treasury Bill policy, which, at any rate, appears to have been quite deliberately undertaken, to borrow on Ways and Means to an unheard-of extent. When the London Money Market had a surplus of floating money, it had the Treasury Bills ready at hand to absorb it; but when there was a monetary tightness, it had only to let some of the Bills, which were constantly maturing and being renewed, run off at maturity in order to get cash. The Government was obliged to borrow from the Bank of England whenever this occurred, and in this way the method of borrowing by means of Treasury Bills necessitated the extension

of the method of borrowing on Ways and Means advances. A most undemocratic method of borrowing this, as it was almost wholly confined to the big financiers; and certainly, owing to the amount for which the Bills were offered, was not available to the ordinary investor.

On the whole, too much weakness was exhibited by the Chancellors in dealing with the problem of financing the war. In the beginning of it, people were quite anxious for taxation, but, owing apparently to a feeling of optimism regarding the probable duration of the war, the tax machinery was not adjusted in time; the excuse was constantly given that the staff employed in the Inland Revenue Department had been too much depleted by the demands of the War Office to allow of any new taxes being effectively imposed. Too much use was made of a very efficient banking machinery, with the unfortunate results of inflated credit, inflated currency, inflated profits and inflated prices. The figure of dead-weight debt gives no idea of the difficulty which the Government caused for itself and the community by this tinkering with finance. Instead of boldly paying for the war by taxation, which leaves no "problems" in its train, the system of borrowing, and especially of borrowing by means of Treasury Bills, has left behind it a very difficult task in the matter of funding a large floating debt; and the war, though paid for as it was fought, by the nation as a whole, except in so far as loans from America were obtained, must again be paid for by the individual members of

the community. Those who hold Government Stock are entitled to receive interest until the capital is repaid. This interest must come from the taxes, and the capital repayment from a sinking fund provided out of revenue; so that the general effect is a payment to the State by the general body of the people in proportion to their tax liability, and a refund by the State to individual members of the population in proportion to the amount of loan stock owned by them. It is a clumsy performance in a civilised community, but it is not very injurious to the productive power of the country. It merely affects distribution; and if it were the only troublesome result of the war finances, the British people might, with good reason, congratulate themselves on the eventual success of the traditional policy of muddling through.

CHAPTER IV

THE WAR FINANCE FROM OTHER VIEW-POINTS : 1. CURRENCY-ISSUES AND PRICES ; 2. INTEREST ; 3. PROFITS ; 4. WAGES

THE Currency and Bank Notes Act, 1914, marks the beginning of the departure from the gold standard in Great Britain. This Act, as has been explained, was passed to provide emergency currency in the credit crisis caused by the derangement of industry at the commencement of the war. But the Currency Notes were not discontinued when the crisis passed. Instead, the amounts outstanding increased continuously. The amount outstanding—

At 31st March	1915	was	. .	£m39.8
,, ,,	1916		. .	106.7
,, ,,	1917		. .	144.7
,, ,,	1918		. .	228.1
,, ,,	1919		. .	328.1
,, ,,	1920		. .	335.4

and has since gone higher.

The Currency Act of 1914 empowered the British Treasury to issue these notes, through the Bank of England, to bankers up to a maximum of 20 per cent. of the total of a bank's current and deposit accounts, and interest was to be paid at current Bank Rate on the amount of notes issued. But in fact the banks found a simpler and cheaper

way of obtaining Currency Notes. By transferring funds from their "balance at Bank of England" to the credit of the Currency Note Account they obtained notes outright without any liability to pay interest. Unfortunately the Government found it necessary apparently to substitute their own securities for the cash in the Currency Notes Account, and thus the notes, which, like all paper money, are promises to pay in gold on demand, were issued, not against gold, but against Government promises to pay loans out of taxes. There was, therefore, no check on the amount of notes which might go into circulation, for the banks were enabled to keep their balances at the Bank of England at a high figure, notwithstanding the transfers made to the Currency Note Account in exchange for notes. Of course the main reason for the issue of notes was the increased amount of credit which the Government created, but the effect is as important as the cause. The Interim Report of the Committee on Currency and Foreign Exchange after the war (Cd. 9182 of 1918) explains in a footnote how the new credit forced the new currency into circulation. "Suppose, for example, that in a given week the Government require £10,000,000 over and above the receipts from taxation and loans from the public. They apply for an advance from the Bank of England, which, by a book entry, places the amount required to the credit of Public Deposits in the same way as any other banker credits the account of a customer when he grants him temporary accommodation. The amount is then paid out to customers and

other Government creditors, and passes, when the cheques are cleared, to the credit of their bankers in the books of the Bank of England—in other words, is transferred from 'Public' to 'Other' Deposits, the effect of the whole transaction thus being to increase by £10,000,000 the purchasing power in the hands of the public in the form of deposits in the joint-stock banks and the bankers' 'cash at the Bank of England' by the same amount. The bankers' liabilities to depositors having thus increased by £10,000,000 and their cash reserves by an equal amount, their proportion of cash to liabilities (which was normally before the war something under 20 per cent.) is improved, with the result that they are in a position to make advances to their customers to an amount equal to four or five times the sum added to their cash reserves, or, in the absence of demand for such accommodation, to increase their investments by the difference between the cash received and the proportion they require to hold against the increase of their deposit liabilities. Since the outbreak of war it is the second procedure which has in the main been followed, the surplus cash having been used to subscribe for Treasury Bills and other Government securities. The money so subscribed has again been spent by the Government and returned in the manner above described to the bankers' cash balances, the process being repeated again and again until each £10,000,000 originally advanced by the Bank of England has created new deposits representing new purchasing power to several times that amount. Before the war these

processes, if continued, compelled the Bank of England to raise its rate of discount, but the unlimited issue of Currency Notes has now removed this check upon the continued expansion of credit."

I come now to the thorny subject of the rise in prices; and I shall deal with it as a question of fact rather than of theory. But before attempting to do so, I may refer to the much spoken-of and much abused Quantity Theory of Money. Had Ricardo foreseen the consequences of his loose and unscientific method of treating questions of money and finance, he would surely never have put a pen to paper. One of the unfortunate results of his legacy of economic writings is this Quantity Theory of Money, which Professor Laughlin, of Chicago University, calls "archaic," "obsolete," "fallacious," and "outgrown"; while Professor Nicholson, of Edinburgh, speaks of the "great foundations of the Quantity Theory," and soundly rates those who look upon it as "an economic Will-o'-the-wisp, or a shibboleth, or something else academic and unpractical." I have searched the edition of Ricardo's works by Gonner and failed to find the so-called Quantity Theory definitely set out. It is a well-known fact that Ricardo did not write at all clearly; his "Principles" read more like the work of Fourier in serious mood than the production of a skilled economist; they are sketchy and scrappy; the arguments do not follow consecutively; there are "frequent ellipses or suppression of some of the links in a long chain of thought" (De Quincey), and the work is

unmethodical. But if he was responsible for the theory, he left it to posterity to complete his exposition of it. His mind, to judge from his writings, was a large one, developed rather at haphazard, and more by the circumstances of his daily life than on any scientific lines. He speaks of monetary problems as if recounting his own experiences in the world of money and of business —just as a farmer will speak of crops, having learned by making mistakes, rather than by thinking first how things ought to be. The only flaw in this theory of money-value as affecting the general price-level, is that it lays special stress on the supply side and relegates the other factors to a parenthesis. It is quite probable that Ricardo did not realise the importance of these other factors, but that is not a reason why his loosely enunciated theory should give trouble to-day (as it has done in recent discussions on the subject), or why his enunciation should be adopted when later economists, e.g., Seligman, have stated the law in precise and scientific terms.

All things in this world that are exchanged by men possess utility. If a comparison of utilities is made, the expression of the comparison, the ratio of the utilities, is called, for each subject, its value. If the utilities of goods are estimated in terms of a standard, their values are stated in terms of units of this standard, and the number of units is called the "price" of the goods. But if the standard itself possesses utility, how is its value to be estimated? It is obviously ridiculous to estimate it in terms of itself; for example, to say

that a sovereign is worth a sovereign. The answer is that all one can do is to ascertain changes in the utility of the standard as they occur from time to time. It is on this principle that it is stated in economic text-books that a general rise in prices is an almost sure index of a fall in the value of money, the comparison being between the utilities of money at two different periods. The value of any goods is the expression of the relation between the effective demand for it and the available supply of it. The value of money is therefore affected by both the demand for it and the supply of it. The demand for money is represented by the amount of money required to effect exchanges of goods. If more is required by industry and is not forthcoming, the value of money increases and prices fall. If less is required and the surplus is not withdrawn, its value falls and prices rise. The supply of money is the amount in circulation multiplied by the rapidity with which it circulates. The value of money is influenced by changes in either the supply or the demand. As to the extent to which the influence is exercised, no formula can be laid down. It differs according to circumstances, and the chief circumstances affecting it are :—(*a*) The comparative extent to which exchanges are accustomed to be effected without any money passing, (*b*) variations in the amount of credit transactions, (*c*) variations in the number and magnitude of the exchanges involving cash. Thus (*a*) the credit system of the country has to be investigated, so that it may be ascertained what percentage of exchanges call for actual cash ;

(*b*) variations in exchanges effected without the use of cash will affect the value of money by affecting the supply; and (*c*) the volume of cash transactions is constantly varying, and thus, by affecting the Demand side of the equipoise, alters the position of the weight which we call Value.

Now, price is the ratio of the value of goods to the value of money. The value of goods is fixed, independently of money, by the effective demand for the goods and the available supply, or rather store, of them, working in opposite directions. The value of money is also fixed in a similar manner by demand and supply, in the sense explained above. Any change, therefore, in the value of goods *inter se*, and any change in the value of money, is reflected in the general price-level. This may seem elementary, and therefore unnecessary to explain in detail; but many people, like Napoleon, are hindered by the elements. What the Quantity Theory wishes to emphasize is that a change in the supply, or "quantity," of money in circulation is a cause which is certain to have a direct effect on the level of prices; add "*ceteris paribus*," and the law is complete! Indeed, the only apparent reason for so much ado about it is that one is apt to overlook the supply of money as an important cause of changing prices, unless it is underlined a few times. Of course the underlining may be overdone.

During the war the quantity of money in circulation in the United Kingdom increased immensely. At first it was said that emergency currency was needed because of the restriction

of credit ; that is to say, a great many transactions which formerly had been carried through without the aid of currency, now needed it. Then it was said, later, that the war had caused an increase in the volume of business, owing to the big Government contracts, and that more money was needed to pay wages bills. Then the third factor in the equation was seized upon, and it was proved that war causes a scarcity of a great many things, and that scarcity prices are higher than normal prices ; and that, therefore, more money was needed for retail purchases. As "rapidity of circulation" is not a thing that would strike the ordinary person, it escaped notice apparently. It was stated that, as there was a much increased need and demand for currency, if the supply was not at once increased, people would need to split farthings, and there would be a danger of a scarcity of currency. Ergo, the supply had to be increased if a crisis was to be avoided. The supply was increased, and as supply affects demand, the increased supply did actually increase the volume of business, and also made scarce things reach a real scarcity price, and things that were not scarce become dear, so that a further increase in supply was needed, and so on over again. Then the comparison of the kitten chasing its tail was used, and more dignified people spoke vaguely of a vicious circle.

It is proposed in this Chapter to attempt to find answers to the following questions :—

(*a*) To what extent has the purchasing medium been increased during the war and up to the end of the financial year 1919-20 ?

(*b*) What effect, if any, has the increase had upon

(1) Retail prices of commodities ?
(2) Interest ?
(3) Profits ?
(4) Wages ?

1. Currency-Issues and Prices.

The word "inflation," applied to currency and credit, has been used many times during and since the war. Like a vast number of words used in economic science, it gained currency before it was properly defined. In dealing with the war-time increase in the currency of the United Kingdom this word may be avoided altogether and so save the need of a definition. Unfortunately, however, the meaning attached to the word "money" is also a matter, even still, of dispute amongst economists, and a precise definition must be given before entering on our investigation. I have used the words "purchasing medium," above, as an equivalent term for "money." This expression fairly well defines the word as used in this treatise. Any object which is employed as a medium for effecting exchanges I regard as money. Thus, while a bank deposit is undoubtedly not money, a bank-cheque is ; also bank notes, currency notes, gold, silver and copper come within our definition.

Table V is intended to show the increases in the various forms of currency since the commencement of the war.

TABLE V

Period	Currency Notes Outstanding	Gold	Increase in Bankers' Cash in Hand	Net Curr. Note Increase	Increase in Silver	Increase in Bronze	Increase in Country Clearings Cheques	Increase in Bank Notes	Net Increase
	£m	£m	£m	£m	£m	£m	£m	£m	£m
1 August, 1914, to 31 March, 1915 .	39.8	80	54	—94.2	3.1	—	—19	11.1	—99
1 April, 1915, to 31st March, 1916	106.7	80	63.4	—36.7	6.1	—.06	178	17.5	165
1 April, 1916, to 31 March, 1917 .	144.7	80	132.5	—67.8	6.3	.15	483	28.7	450
1 April, 1917, to 31 March, 1918 .	228.1	80	123	25.1	1.8	.23	854.5	41.7	923
1 April, 1918, to 31 March, 1919 .	328.1	80	154.6	93.5	?	?	1,346.5	80.8	1,521
1 April, 1919, to 31 March, 1920 .	335.4	80	204.7	50.7	?	?	1,997.5	93.1	2,141

The figures represent £m=millions of pounds Sterling.

Regarding Currency Notes, as these were originally designed to take the place of gold, and as they did actually, in course of time, entirely displace gold from circulation, a deduction of the average pre-war gold circulation has been made. This deduction amounts to £m80, which is the generally accepted figure of the pre-war gold circulation in the United Kingdom.*

A further deduction from the Currency Note issue has been made, and is shown separately, in respect of increased "Bankers' balances at the Bank of England." It needs to be deducted in arriving at the circulation, as the increased cash is (almost wholly it is presumed) in Currency Notes, and, being locked up in the banks, these do not enter into circulation, and affect it only by the increased bank notes, and especially by the increased cheques (drawn against the increased deposits to protect which the increased cash at call is available) which they permit. The bank notes and cheques being included elsewhere in the table of figures, there would be duplication if this item were not deducted.

Regarding cheques, very great difficulty was experienced in obtaining proper statistics of even

* The total amount of gold in the banks and in circulation in 1913 is taken as £m160, made up as follows:—

In Bank of England . . .	£m46
In the other Banks . . .	34
In Public circulation . . .	80
	£m160

These figures have been calculated from some statistics contained in the paper entitled "Currency Statistics" prepared for the International Financial Conference held in Brussels in October, 1920.

an approximate correctness. The Bankers' Clearing House Returns have been relied upon in this connexion. These are published under three headings, namely, Town Clearings, Country Clearings, and Metropolitan Clearings. To take the total of the three is obviously, for our purposes, incorrect, since a great part of the Town and Metropolitan Clearings is composed of financial cheques, as distinct from industrial or commercial cheques. This is forcibly demonstrated in the effect which the closing of the Stock Exchange had on the Clearing House Returns. The following are the figures over the seven years :—

TABLE VI

Year	Town and Metropolitan	Country	Total
	£	£	£
1913 .	15,046,923,000	1,389,481,000	16,436,404,000
1914 .	13,294,584,000	1,370,464,000	14,665,048,000
1915 .	11,840,154,000	1,567,571,000	13,407,725,000
1916 .	13,402,595,000	1,872,451,000	15,275,046,000
1917 .	16,879,006,000	2,244,190,000	19,123,196,000
1918 .	18,461,239,000	2,736,273,000	21,197,512,000
1919 .	25,028,614,000	3,386,768,000	28,415,382,000

The total fell in 1914 from £m16,436.4 to £m14,665, a drop of £m1,771.4 ; but the Town Clearings account for £m1,752.3 and the Country Clearings for only £m18. More striking still are the figures for 1915, when the Town Clearings

dropped a further £m1,454, while the Country Clearings recovered £m197. Still, some of the Town Clearings are in respect of cheques drawn against exchanges of goods (as opposed to securities), and, as such, ought to be included; and it is possible that these may have increased in 1915, but that the bigger decrease in cheques drawn against transfers of stocks, etc., has more than cancelled their increase. In the table which I have prepared I have omitted altogether the Town and Metropolitan Clearings, and, with some misgivings, I have included the figures of Country Clearings only, as representative of the total cheque currency. It is unlikely that they do not contain cheques drawn against financial transactions, and therefore powerless to influence retail prices of commodities, for example; but there is no means, that I can see, of finding out how much, if any, relates to financial dealings.

Many writers on this subject have loosely referred to the increased Banking Deposits as a cause of high prices. They are not in themselves a direct cause of high prices, because they are not currency; and if allowed to remain undisturbed, they cannot have any effect on prices. It is only when a cheque is drawn against the Banking Deposits that their influence is felt. This is why I have ignored deposits and attempted to include cheques. The connexion between cheques and deposits is obvious, and the following tables are designed to show how constant the ratio is between the two during a period of continuous and rapid movements in the amounts. It will be noted that

the ratio is more constant in the case of the Country Clearing returns than in the Town and Metropolitan Clearings, the latter being disturbed by other influences besides those which affect prices of goods.

TABLE VII (*a*).

Year	Banking Deposits	Total Bankers' Clearings	Ratio
1913 . .	1,077	16,436	1 : 15
1914 . .	1,258	14,665	1 : 12
1915 . .	1,211	13,408	1 : 11
1916 . .	1,584	15,275	1 : 9
1917 . .	1,827	19,121	1 : 10
1918 . .	2,110	21,197	1 : 10
1919 . .	2,500	28,415	1 : 11½

TABLE VII (*b*).

Year	Banking Deposits	Country Clearings	Ratio
1913 . .	1,077	1,390	1 : 1·3
1914 . .	1,258	1,370	1 : 1·1
1915 . .	1,211	1,568	1 : 1·3
1916 . .	1,584	1,872	1 : 1·2
1917 . .	1,827	2,244	1 : 1·2
1918 . .	2,110	2,736	1 : 1·3
1919 . .	2,500	3,387	1 : 1·3

The net result of the inquiry as to the actual currency increase is shown in the last column of Table V, and seems to point to the following conclusions :—

(1) there was a decrease in currency in the first six months of the war ;
(2) there was a rapid increase in the first full war year, and this was accelerated, year after year, up to the end of the financial year 1919–20.

The drop in the net amount of money in circulation in the early period of the war is not surprising. As will be shown later, the same phenomenon appeared during the same period in the London Money Market. The war caused a sudden stoppage, to a great extent, of industry. There was a period of inactivity, when unemployment was rife, money could be had at an abnormally low rate of interest, and enterprise had altogether ceased. Later on, the Government (or as people, going to the source, said, the war) altered matters. Just as the big Governmental demand for credit made money rates jump from April, 1915, so the big demand made by the Government for munitions and war equipment for the Army and Navy caused, as soon as the early transition stage had been passed, a boom in trade, which contrasts with the period from August, 1914, to (say) March, 1915, as the appearance of a fever patient, for example, contrasts with that of a hunger-striker.

Currency having expanded to a very great extent, and the production of goods having remained

normal, or perhaps increased a little, but obviously to an extent nothing like that to which the currency increased during the war, it follows from the Quantity Law of Money that general prices should have risen. Two influences, however, which have been ignored are (*a*) the velocity of circulation and (*b*) the effect of credit. Of these, the former is likely to have had an effect, small, no doubt, in relation to the other influencing factors, on prices, and its effect would be towards their general increase. It is, of course, impossible to measure rapidity of circulation; but from the truth of the saying, "easily got easily spent," and from the stories often heard during the war of luxuries, such as pianos, gramophones, etc., being in the houses of people who before the war were wandering about the poverty line, one may conclude that the new money was not kept long in the pockets of the recipients. Such rapid spending flushes trade all round; there is an uneasy nervous activity in business; it encourages speculation and discourages thrift. We may reasonably assume, therefore, that the velocity of circulation was increased as the amount of currency was increased, without of course laying down any ratio of increase; that would be clearly impossible.

As regards credit, it may be pointed out that it does not enter into our discussion at all. Credit, as shown in the preceding Chapter, was a very important cause of the big issues of Currency Notes. But if we regard the cheque as money, then we need no longer worry about credit, for

it can influence prices only when it is, by means of the cheque, transformed into buying power.

Before the war there was a certain amount of currency, including cheque-currency, used to effect a certain volume of exchanges of goods ; the value of the total of these exchanges expressed in money was equal to the amount of currency used, multiplied by the number of times it changed hands. During the war, the amount of currency has, as shown, enormously increased. The volume of exchanges of goods has not, we take it, increased very much, at any rate relatively to the increased currency ; the number of times money has changed hands has, we assume, increased, though we cannot measure the increase even approximately. From these considerations, what conclusion can we draw with regard to prices in general ? Broadly, it is easy to say that prices should have risen ; but when we try to find by how much, leaving out other factors, such as the scarcity of certain goods (i.e., their Supply), or the increased Demand on the part of the fighting forces for commodities, we find that no definite answer can be given. The reason is that there are so many unknowns in our equation :—

If V=volume of exchanges effected by currency in any pre-war period.

If V_1 =volume of exchanges effected by currency in any corresponding war period.

If C=amount of currency pre-war, and
C_1 =amount of war currency.

If R=pre-war rapidity of circulation, and
R_1 the rapidity of circulation during the war.

Then the general level of prices pre-war (P) compares with the general level of war-prices (P_1), for any particular period, as

$$V \times C \times R \ : \ V_1 \times C_1 \times R_1.$$

We want to find P and P_1; or rather $P : P_1$; but V and V_1 are unknown quantities—at least I myself cannot ascertain them; R and R_1 are also unknown, and I doubt if anybody could estimate their value. Leaving them out, on the assumption that V is approximately equal to V_1, and R to R_1, we get the ratio $P_1 \times C_1 : P \times C$. But $C : C_1 :: 1401 : 3547$ (worked out in Appendix).

$$\therefore \frac{P_1}{P} = \frac{3547}{1401} = 2{\cdot}53.$$

That is to say, the effect of the entire currency-issues, from the August of 1914 to the 31st March, 1920, would appear to be to alter the general level of prices from 1 to 2·53 or from 100 to 253.

So much for what ought to be the effect of the currency-issues on prices. Let us see how prices have risen since before the war. According to the Board of Trade (*Labour Gazette*, March, 1920) the average increase since July, 1914, at 1st March, 1920, was 130 per cent.; the items included are food, rent, clothing, fuel and light, but, as explained at length in the same issue of this paper, the statistics are designed to measure the average increase in the cost of maintaining the

pre-war standard of living of the working-classes, and the weights employed are based on the average expenditure shown by 1,944 working-class family budgets collected by the Board of Trade in 1904. Too much importance may easily be given to such statistics; for the purpose of a comparison with currency, they, in common with all other "index number" calculations, are useless. In the first place they tell nothing of the actual volume of goods exchanged and their price; and obviously a comparison cannot be made between a *percentage* (of price increases) and a *total increase* (of currency). Secondly, the percentage is, in the Board of Trade figures, a percentage of 17*s.* $1\frac{8}{4}$*d.*, multiplied by the weights. To compare this with the percentage increase in the currency is to compare two non-comparable percentages, for the currency is measured by reference to a pre-war figure of over £m1,000. Yet this comparison has been made over and over again in discussions of this subject, and even by well-known authorities. For example, Professor J. L. Laughlin, in *Credit of the Nations*, says (page 120): "Combining the loans of the Bank of England with those of the English Joint-Stock Banks (using deposits as a measure) there has been a rise of not over 33 per cent. . . . . There is nothing which could be appealed to as the cause of a rise in prices of 100 per cent." Which comparison is as absurd as, to use Professor Laughlin's own simile, to compare sore-throat cases with statistics of diphtheria. The comparison is fallacious, as like is compared with unlike.

Again, such a clear thinker as Mr. Hartley Withers, in *War-time Financial Problems*, remarks (page 233), "... the issue of Currency Notes has taken place to the tune of ... £m300. ... When we also remember that there has been a very heavy coinage of silver and copper, ... the behaviour of commodities of ordinary use in rising by nearly 100 per cent. seems to be an example of remarkable moderation." There is here an implied comparison between the gross Currency Note issue and the percentage increase of some prices, which is, to say the least of it, unscientific.

Returning to Professor Laughlin's figures, it may be pointed out that a comparison of deposits and prices in 1913, and a further ratio of deposits to prices in 1919 or 1920, would throw some light on the subject. If the ratio is the same in both cases, then general prices have risen in proportion to the increased deposits. If the ratio lags, then other causes enter in to explain the rise of prices, prices having risen in a faster ratio than deposits increased; if the deposits went faster, one must assume that some other factors kept prices lower than they ought to have been if these restraining influences had been absent. But such a comparison cannot be made, as already explained, because of the absence of the figures for total price payments.

It is not correct, of course, to attribute the entire rise in prices to the currency. There were other influences at work, too. But unless the currency had been increased, prices could not have risen. Some prices would have risen, and others

(of luxuries, for example) would have fallen. There were influences at work during the war to make things scarce, such as (*a*) reduction of output of industry in the United Kingdom due to the withdrawal of labour to the fighting units, and due also to the new direction given to the labour that remained and to the new labour of women and old men which was availed of; (*b*) increased demand for goods by the war authorities for consumption by the fighting forces. It is generally agreed that the standard of living amongst the troops was higher, on the whole, than the standard of living maintained by the individual units in their families before the war, and certainly the pre-war army standard of rations was augmented on a big scale during the war; (*c*) dependence on America and Canada for supply of food stuffs, particularly wheat (in the absence of any supplies from Russia), left us at the mercy of speculators, and they exerted an influence towards raising food prices; (*d*) increased cost of production due to heavier taxation, freights, and increased cost of materials, is also a factor which cannot be ignored.

Where these influences are foreign influences, it is hard to see how an increase in the currency could have been avoided without very great hardship to the poor, for the result would have been that the rich, who, before the war, indulged in luxuries to a large percentage of their total incomes, would have been compelled by the rising prices—their incomes remaining unchanged—to transfer part of their luxury-expenditure

to expenditure on necessaries; and thus, while luxuries would have fallen in price (at first and until the supply was drastically reduced to meet the reduced demand), necessaries would have risen to a scarcity price; and the poor, whose pre-war percentage of income expenditure on such commodities left little over for unnecessaries, would have found themselves unable to compete with the rising prices. This would have caused very real hardship and great discontent and unrest, and the effect of this on the progress of the war might have been very serious. For this reason, an increase in currency to meet this particular difficulty was certain to be beneficial on the whole.

But price-raising influences which are not foreign, but domestic or internal, would have had no general effect on prices, if the currency had not been added to enormously. Thus the above-mentioned item, "increased cost of production" of commodities, could not possibly have had a general effect in raising prices if the currency had not been augmented; because, if people had not had an increased amount of money to spend, they would not have been able to keep up their pre-war consumption of all commodities at higher prices. A transfer from luxuries to necessaries, a complete disuse of luxuries in many cases, and, perhaps, a new and extended meaning to the word "luxury," would have been the result. Consumption would have been adjusted to the new price-conditions. Wages and profits, which have undoubtedly increased during the war-period and have contributed

towards a huge advance in commodity prices, would have been kept in check. The crime committed by those responsible for the Government's financial and currency policy, was that no limitation whatever was placed on the amount of Currency Notes that might be demanded by the banks and put into circulation. The notes were themselves the proximate cause of the high and increasingly higher general price levels during and since the war; but the notes were the result of the manner in which the Government obtained the nation's credit to finance the war.

2. Interest.

The rate of interest is determined by the equilibrium of the opposing forces, Demand and Supply; if Demand increases and Supply remains the same, money appreciates and the rate of interest rises. By interest here is meant pure economic interest, and for such there is at any time only one charge. Eliminate the elements of risk and of monopoly, and the rate of interest in any area, at any time, is the same. It is natural to look for a big increase in the interest rate in war-time; for huge sums of money, representing wealth, or control over wealth, have to be raised for the prosecution of the war; and thus the Demand is considerably swollen, while the Supply cannot be expected all at once to rise to meet this new Demand. The supply of investment capital is a fund which is normally renewed from the savings of the people made from their incomes.

The total income of the United Kingdom (pre-war) was estimated at from £m2,000 to £m2,500, and the average savings at £m410, say 20 per cent. of income. This was the fund which, not being at once consumed, was available for further production; and this, added to the existing fund, which was constantly being depleted and renewed, represented, on the material side, the supply of investment capital. There were, of course, influences, which cannot be expressed in figures, which affected the supply; such, for example, as speculation. And not all of the yearly savings were available to meet the home demand, about half being sent abroad to new countries, which urgently required capital for their development. Without going into further detail, it may be stated that the rate of interest before the war was governed by the needs of the *entrepeneurs* of industry, great and small, in ratio with the supply of available investment money. As a general rule, Demand had greater influence in changing the rate than the Supply, as the latter was difficult to increase. Thus a boom in industry was heralded by a hardness in the money market, because Demand rose faster than Supply. The last such boom before the war was in 1907, and beginning in America, its effects, as is the case in credit crises, were felt all over the world. In the depression that followed, the rate of interest fell considerably. It is to this period (1908–09) that one must go to find an average Bank of England Discount Rate lower than it was in the half-year immediately preceding the war.

The following is the course of the Bank Rate during the war :—

AVERAGE RATE.

	Per cent. £	*s.*	*d.*
Jan.-June, 1914	3	4	7
Jun.-Dec., 1914	4	16	10
Year 1915	5	0	0
,, 1916	5	9	3
,, 1917	5	3	0
,, 1918	5	0	0
,, 1919	5	3	0
Jan.-June, 1920	6	8	7

There is nothing very abnormal about these rates ; they are surprisingly low, considering the heavy war expenditure, i.e., increased Demand, and the dislocation of industry which must have lessened the Supply. The natural thing, we have said, for the Interest Rate in time of war is to rise. Unless a Government has a big balance to its credit, its war-time demand must, in the beginning, be a credit demand, for it cannot at once adjust its tax-machinery so as to obtain cash to pay for the materials of war. And if, so far from at once adjusting its tax-machinery, it neglects to do so during the entire war period, then its demand is based on credit all the time. Such was, to a very great extent, the demand of the British Government during the late war. And as this credit which the Government obtained from its people was based on goods (whether actually produced or to be produced), and as the output of goods was not increased correspondingly

with the increased demand, somebody had to go short, and shortness means a scarcity price; and, if the ordinary demands of industry for capital had not been curtailed, competition would have forced the rate of interest to an unheard-of height, and driven many manufacturers to an early grave. But the wheels of industry, which ordinarily require a certain amount of lubrication, in the shape of increased capital expenditure, were allowed to go without during the war; and in this way the demand was very much restricted. But this is not by any means sufficient to explain the low Bank Rates. Perhaps the solution is to be found on the Supply side of the balance. What effect should the increase in the currency have on the Interest Rate? The answer is, none. For, if a hundred pre-war pounds gave its owner a yearly income of five pounds, and if this five pounds is, during the war, worth only two pounds ten shillings, owing to the increase in the general price level, it cannot be argued that the rate of interest has fallen from 5 per cent. to 2½ per cent., since the hundred pounds investment is now worth only fifty pounds; so that the rate of interest has not changed. But what effect should the increase in currency have on the supply of investment capital? The answer again is, none. If out of a pre-war income of £m2,000, £m410 was saved; and if the income during the war was doubled in terms of money whose value had, let us say, halved, then the savings ought, normally, be £m820, representing only the same investment power, because the

same purchasing power, as when the figure was £m410.

A further point to notice is that the millions which before the war were invested abroad were retained in England during the war, as there was a Government prohibition against the export of capital (Regulation 41 D of D.O.R.A.); and other influences which would increase the supply were the special attractions held out by high interest rates for foreign deposits, and also the use made of pre-existing capital, in the nature of foreign securities, to pay for purchases from abroad.

But the real explanation is not to be found either in the Demand or in the Supply side. There are two reasons why Bank Rate was so abnormally low during the war: firstly, it ceased altogether to be an index to the true rate of interest, and secondly, the rate of interest was not allowed to follow economic laws, but was artificially controlled by the Government.

It is proposed here to consider (*a*) the reasons which dictated the Government's action in controlling the money market; (*b*) the manner in which the control was exercised; and (*c*) the general effects of the control.

Up to the beginning of 1915 the Bank of England rate of discount was the controlling rate of interest in the United Kingdom; and the Market Rate, i.e., the rate at which £100 could be had from the dealers in money in Lombard Street, was always in correspondence with, and slightly below, the Bank Rate. In 1913 the average Bank Rate

for the year was £4 15*s.* 5*d.* per cent. And this was higher than in any year since 1907, the year of the American crisis. In fact this rate was exceeded only eleven times since 1842, and always for some disturbing cause in financial circles. This looks like a crisis rate; but in the first six months of 1914 the rate was £3 4*s.* 7*d.* per cent., and to find a lower rate it is necessary to go to 1909, when the depression following the 1907 crisis made money cheap, because enterprise was for a time checked. Both these periods—the year 1913 and the first half of the year 1914—were pre-war periods, and the war, therefore, could have had no direct influence on them. Nevertheless, the explanation of the discrepancies between the rates, and of the singularity of the rates, is to be found in the war itself. Coming events cast their shadows before; and the war did not belie the proverb. It is difficult to point definitely to any fact or to a statement by any responsible public official which would show that the approach of war was being felt at the beginning of 1914; at the time the ordinary reader of the political skies could have seen nothing extraordinary in the aspect of affairs. There were Balkan troubles of course, and civil war in Mexico; Brazil was in difficulties with her finances; there were labour troubles on the Rand; financial chaos in India; and the usual periodical revolution simmering in Portugal. But there was nothing here on which to build a theory of a world-war. What is easy, however, is to trace the shadow of the war, now that the war is over.

It can be traced in the after-dinner speeches of monarchs, for example, and in the war cries of certain embryonic revolutionaries within the United Kingdom; but nowhere, I think, will you find it more clearly revealed than in the reports of "our Berlin Correspondent" and "our Paris Correspondent," in the financial papers of the time.

It seems at first sight rather surprising that political events should have any influence on the money markets; yet the financial columns of the daily papers constantly refer to the effect of even a minor politician's speech on Exchange. The reason for this is not difficult to understand. The rate of interest is the rate of credit; and interest is the price paid for credit. Credit cannot exist except there is security, and the more perfect the security the stronger and more powerful is the system of credit. If the security of a people is disturbed, or threatened with disturbance, credit is shaken and enterprise is checked.

Up to and during the year 1913 money was getting dearer and dearer, because the demand for it was increasing. Armaments were being built at feverish haste, and for this, money was urgently needed. In 1913 Russia floated a £m24 loan, and Belgium a £m12 loan; the debt of France was £m1,587 and of Germany £m1,262, England's being only £m708. From the *Economist* of 8th March, 1913, we learn that "the announcement of extraordinary demands in Germany and France for armaments has caused a general feeling of

uneasiness, and alarming reports have been current as to the situation in Berlin, which our New York correspondent describes as a crisis. Certainly money is very scarce in Germany, and there has been renewed liquidation there of some international stocks." In 1914 the shadow began to appear; and it was first noticed by the dealers in credit; seismic shocks of the coming catastrophe were being registered on the European stock markets; credit was restricted; enterprise, feeling this, was checked; and so demand fell off, and money rates dropped, till the final crash came in the Summer of 1914.

When the war broke out, England at once ceased investing abroad, and began to call in the short credits which she had outstanding in such countries as the United States, Australia, Brazil, China, Canada, Japan, and the South and West Coasts of Africa. At the same time that the supply of capital was thus increased the demand began to fall off, no new enterprises being started by reason of the troubled state of affairs; and the big Governmental requirements did not all at once fill the gap thus created. The result was that money became abundant and cheap. Thus, in the first half of 1915 the average market rate of discount was as low as £2 9*s*. per cent., being £2 11*s*. per cent. below Bank Rate, and it had fallen to £1 5*s*. 8*d*. per cent. at the end of the second week in February. Demand had fallen faster than Supply, and the Market Rate showed the true state of the money market, the artificial Bank Rate being uninformative. The following

table shows the variations in the average half yearly rates during the course of the war :—

TABLE VIII

Year	Bank Rate	For Year	Market Rate 3 Months' Bills	For Year	Difference	
	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
1912—First Half	3 9 1	3 15 5	3 5 5	3 12 7	0 3 8	0 2 10
Second Half	4 1 9		3 19 10		0 2 11	
1913—First Half	4 15 11	4 15 5	4 6 10	4 7 5	0 9 1	0 8 0
Second Half	4 14 11		4 8 0		0 6 11	
1914—First Half	3 4 7	4 0 9	2 10 2	2 17 8	0 14 5	1 3 1
Second Half	4 16 10		3 5 3		0 11 7	
1915—First Half	5 0 0	5 0 0	2 9 0	3 14 1	2 11 0	1 5 11
Second Half	5 0 0		4 19 3		0 0 9	
1916—First Half	5 0 0	5 9 3	4 17 6	5 4 3	0 2 6	0 5 0
Second Half	5 18 6		5 11 0		0 7 6	
1917—First Half	5 6 0	5 3 0	4 16 7	4 16 2	0 9 5	0 6 10
Second Half	5 0 0		4 15 9		0 4 3	
1918—First Half	5 0 0	5 0 0	3 13 0	3 11 9	1 7 0	1 8 3
Second Half	5 0 0		3 10 5		1 9 7	

It will be noted how the Market Rate comes into line with the Bank Rate in the second half of the year 1915, the difference being only 9*d.* per cent., and the two are in fair agreement up to the end of the war. In the artificial Governmental control of the money market is to be found the explanation of this, for the above rates are far too low for war-time, especially a war-time when the Government expenditure in the period from August 1st, 1914, to November 11th, 1918, reached £m8,612.

It should be pointed out that there was no Government interference before the April of 1915. Prior to this things had gone more or less according to economic circumstances. Thus money rates dropped, and even the £m350 War Loan issued in December, 1914 (3½ per cent. at 95 = £3 13*s.* 9*d.* per cent.), was not sufficient to absorb the entire funds of money left idle by the stoppage of industry due to the war; dealings in stocks practically ceased, releasing further supplies of money; and the exchanges moved rapidly at the command of economic laws. It was the movements of the Foreign Exchange rates that caused the Government to interfere in the London Money Market, and particularly the movements of the New York Exchange. At the outbreak of war, England, then the gold centre of the world, was a creditor of all the other financial centres. The Moratoria on the Continent, and the prohibition of exports of gold, enabled foreign debtors to leave their debts unpaid for the time; but in New York there was a wild

rush for bills on London, which forced the Exchange rate, whose par is $\$4.86\frac{2}{3}$, up beyond normal gold point of $4.90. On the 31st July the rate was $6.35. By November of 1914 it had swung back towards normal, and on the 31st December, 1914, was $4.86. The sudden rise in the rate was due to the demand on the part of American importers for bills to pay their debts to England. It would have been wiser, if possible, had the debts been renewed, say for three months, until the movement of goods from America to England should have brought the exchange back again. At that time, however, even the best informed people believed that the war would be over by Christmas; nobody seemed to have thought of settling down to live under the new conditions; and so it was not reckoned that goods, on the vast scale actually reached, would be imported from the United States of America. It was when, in the year 1915, the balance of indebtedness was growing heavier and heavier against England, and the exchanges were becoming daily more unfavourable, that the Government found it necessary to attempt a solution of the exchange problem. The rate fell as low as $4.49 on 1st September, 1915, this being the lowest point touched. With money abnormally plentiful and cheap in London there was little or no attraction for foreign investment; and the submarine menace prevented gold shipments. Also, as cheap money is an encouragement to imports, it was considered advisable to take measures to change the state of affairs in the home market. The average Market

Rate in the first six months of 1915 was the lowest recorded, for any corresponding period, since 1909, and the American Exchange was falling as follows :

AMERICAN EXCHANGE RATE.

	$
31st December, 1914 . .	4.86
31st January, 1915 . . .	4.85½
28th February, 1915 . .	4.81
31st March, 1915 . . .	4.80
30th April, 1915 . . .	4.79¼
31st May, 1915 . . .	4.78¾
30th June, 1915 . . .	4.77⅛

It continued to fall, and at 30th July, 1915, was $4.76⅞ ; at 31st August, 1915, $4.59¾ ; and on 1st September, 1915, touched $4.49.

In pre-war days, whenever the exchange was unfavourable, the Bank of England raised its discount rate, and if the Market Rate did not follow suit, the Bank, by borrowing from the market, made money scarce, and thus forced a higher rate. There were, therefore, two methods employed to correct an adverse exchange. The course of the war had shown that an artificial Bank Rate had ceased to have any control over the Market Rate. The market had enough funds to supply the needs of all, and none need go to the Bank for accommodation. Therefore it was clearly useless to raise the Bank Rate. The other method was employed by the Government. As it was now controlling the Bank of England and issuing currency, it found itself saddled with the responsibility of finding a corrective for the low

interest rate, which was so bad for the Foreign Exchanges, which themselves in the ordinary course were bad enough, owing to the exceptionally heavy imports from the United States of America. The Government accepted this new rôle, and carried out the function by absorbing as much of the market's idle funds as would bring the Market Rate into line with the artificially high Bank Rate. The policy began in the middle of April, 1915. It was not, of course, the sole or direct mode of correcting the adverse exchanges. Emphasis has been laid on this aspect of the question, because, so far as I can trace, the exchange question was the main problem which influenced the Government in its policy of interference in the money market during the war.

The main features of this policy were the creation and sale of short-dated Government securities, in the shape of Treasury Bills, and the borrowing by the Government, at fixed rates, of bankers' surplus balances. The Treasury Bills were sold for the first time at the Bank of England, at advertised rates, on 15th April, 1915. The rates were so fixed and the Government's power of money absorption so great that from this date the price of Treasury Bills governed the rate of money in the London market. All surplus funds were invested in these three, six, nine or twelve months' bills, and the money lenders were very glad to have such an attractive investment for their surpluses.

Regarding, just for a moment, the political

aspect of this policy, it may be noted that when a Government interferes with the industrial system and the financial machinery of its people, political considerations are apt to be given an importance which they would not otherwise possess. There were two ways in which the Government might have obtained money for the financing of the war. I speak not now of taxation of incomes; but, assuming the necessity of creating large Government credits, there were two alternatives. The one was that actually employed on an immense scale, i.e., the creation of shortly-maturing credits, the money being advanced chiefly by the professional money dealers. The other alternative was to tap the resources of the community at large and obtain the loans from the savings of the people. This policy, too, was adopted, but not till a much later period; and it was at no time relied upon to the same extent as the Treasury Bill policy. Even when at length adopted, it was long before facilities were given to the small investor to place his savings at the disposal of the Government. Later on, the device of the War Savings Certificates was the source of a large revenue, although started at a time when people were in no mood for saving. The first War Loan was offered in no smaller a denomination than £100; Treasury Bills were not for a very long time broken into smaller than £1,000 lots; and special facilities were not given to Savings Bank depositors, who represent, generally, the very small investors, to subscribe to the War Loans. In general, the Chancellors, especially Mr. McKenna,

appear to have deliberately ignored the country at large in the interests of the professional money dealers in London. It was, of course, easier to obtain large credits from this class than to attempt to encourage saving on the part of the masses, and to gather in the small amounts available from this source. This was done later, when the other method was beginning to show dangerous results, owing to the inflation of credit which it caused. It is possible, of course, that the moneyed minority had influence over the Chancellors, more especially perhaps over the Director of the London Joint City and Midland Bank; and that this influence was employed in the interests of the few rather than in those of the general community. Such things happen, of course; but one can only surmise. It is at any rate clear that the people whose chief business was dealing in money found themselves in clover when the Government began the policy of offering them first-class short-dated securities at a rate of interest double that which under normal conditions of trade they would have obtained. It is also clear that the same policy of money-market control, which in the beginning gave a higher rate of interest than might have been given, did later keep the price of money lower than under the force and direction of the economic law of Supply and Demand it ought to have been, and that, by this means, a very great depreciation of securities was avoided. Again, it may be merely a coincidence that this action benefited the moneyed classes at the expense of those who paid for the policy by the tax of high prices.

The Treasury Bill Rate assumed during the war the position previously held by the Bank Rate. In fact it was more effective (though, of course, a great deal more expensive) as a method of controlling the money market. The following table gives the changes in Treasury Bill rates, from the date of their first issue at fixed rates down to the 15th April, 1920, when the industrial demand for capital was making itself felt in the money market, and forced the rate for the three months bill up to 6½ per cent., Bank Rate being 7 per cent.

It will be noticed (p. 94) that the rate paid by the Government for this type of credit kept increasing from 2¾ per cent. in April, 1915, to 5½ per cent. in January, 1917. The amount of Bills outstanding at the end of 1915 was £m380; and at the end of 1916 £m1,148. On the 27th September, 1916, an issue of Exchequer Bonds, maturing in three years and bearing interest at 6 per cent., was made, the intention being apparently to reduce by this means the large volume of outstanding Treasury Bills. In February, 1917, the third War Loan (5 per cent. at 95), Mr. Bonar Law's great effort, was floated and proved successful; as a result of it the amount of Treasury Bills was reduced to £m454 on the 14th April, 1917. Their sale had been suspended in February, but on the 30th March, 1917, was resumed, this time by tender, i.e., no particular rate was published, but big lots were knocked down, as it were, to the highest bidders. On the 19th June, 1917, the old system of sale was resumed, and by the end of the year the amount

Treasury Bill Rates.

From	To	3 Mths.	6 Mths.	9 Mths.	12 Mths.
15th April, 1915	8th Aug., 1915	$2\frac{3}{4}$	$3\frac{5}{8}$	$3\frac{3}{4}$	$3\frac{3}{4}$
8th Aug., 1915	28th Oct., 1915	$4\frac{1}{2}$	$4\frac{1}{2}$	$4\frac{1}{2}$	$4\frac{1}{2}$
28th Oct., 1915	12th Nov., 1915	$4\frac{3}{4}$	$4\frac{7}{8}$	5	5
12th Nov., 1915	24th Mar., 1916	5	5	5	5
24th Mar., 1916	16th June, 1916	$4\frac{1}{2}$	$4\frac{3}{4}$	$4\frac{3}{4}$	5
16th June, 1916	14th July, 1916	5	5	5	5
14th July, 1916	27th Sept., 1916	$5\frac{1}{2}$	$5\frac{3}{4}$	—	6
27th Sept., 1916	4th Jan., 1917	$5\frac{1}{2}$	$5\frac{1}{2}$	$5\frac{1}{2}$	$5\frac{1}{2}$
4th Jan., 1917	Sale of Treasury Bills suspended	—	—	—	—
30th Mar., 1917	Sale by Tender reintroduced	—	—	—	—
19th June, 1917	3rd July, 1917	$4\frac{1}{2}$	$4\frac{1}{2}$	—	—
3rd July, 1917	27th Dec., 1917	$4\frac{3}{4}$	$4\frac{3}{4}$	—	—
27th Dec., 1917	14th Feb., 1918	4	4	—	—
14th Feb., 1918	31st May, 1919	$3\frac{1}{2}$	$3\frac{1}{2}$	—	—
31st May, 1919	Sale suspended. Issue of Funding Loan, 4 per cent at 80.	—	—	—	—
14th July, 1919	6th Oct., 1919	$3\frac{1}{2}$	4	—	—
6th Oct., 1919	7th Nov., 1919	$4\frac{1}{2}$	5	—	—
7th Nov., 1919	5th April, 1920	$5\frac{1}{2}$	$5\frac{1}{2}$	—	—
15th April, 1920	—	$6\frac{1}{2}$	6	—	—

20th July, 1915, Second War Loan $4\frac{1}{2}$ per cent. at 100.

27th September, 1916, issue of 6 per cent., 3 year Exchequer Bonds ; issue of Third War Loan 5 per cent. at 95.

2nd January, 1918, Home Money $3\frac{1}{2}$ per cent., Foreign $4\frac{1}{2}$ per cent.

14th February, 1918, Home Money 3 per cent., Foreign $4\frac{1}{2}$ per cent.

6th November, 1919, Bank Rate raised to 6 per cent.

15th April, 1920, Bank Rate raised to 7 per cent.

had again exceeded £m1,000, and stood at £m1,057 at 22nd December, 1918.

The drop in the interest rate to 4 per cent. was due to the differentiation made in November, 1917, between home and foreign money. Special rates for foreign deposits had long been advocated. It was argued that, as the Government controlled the money market at home, and had a practical monopoly of the demand, it could obtain just as much credit as it was getting at a lower price than it was paying. The chief objection to a low rate of interest was the danger of encouragement to imports, and the small inducement it held out to foreigners to place their deposits in London. But the differentiation policy met both objections, and from this date was successfully carried through by the State-controlled Bank of England.

On the 1st October, 1917, War Bonds began to be sold, and War Bond campaigns were undertaken on a vast and enthusiastic scale. The grip which the Treasury Bills had on the market's resources is very noticeable in the progress made with the sale of these War Bonds. In the thirteen weeks, from 1st October, 1917, to 31st December, 1917, the average weekly subscriptions amounted to £m16. The Chancellor was disappointed, having asked for an average weekly amount of £m25. Then the Treasury Bill rate was lowered to 4 per cent., on 27th December, 1917, and to 3½ per cent., on 14th February, 1918, and in thirteen weeks from 1st January, 1918, to 30th March, 1918, the subscriptions to War Bonds averaged weekly £m34.

Notwithstanding the fact that £m1,343 was

subscribed to War Bonds and War Savings Certificates in the calendar year 1918, the amount of Treasury Bills outstanding at the end of this year was £m1,095 ; and in May, 1919, when their sale was suspended so as to attract money to the Funding Loan, was £m1,036. By 21st June, 1919, the amount had been reduced to £m852, but by the end of 1919 had again overtopped the £m1,000 limit. On 31st March, 1920, they stood at £m1,059.

The theory and the facts of this brief survey of money rates in the war-time are simple and easy enough to grasp ; the effects of the Government's policy are more difficult to ascertain. Undoubtedly the method of borrowing from the financiers and money dealers was overdone ; and ordinary people were not invited or forced, as they ought to have been, to curtail their expenditure, and invest their savings in Government securities. The success of the War Bond campaign was very great, considering the temper of the people at the time it was initiated. The Government was then being generally accused of extravagant expenditure. Out of its own mouth the accusation came at times ; for example, commissioners investigating the conduct of new Government departments drew up reports, which the Government issued to the public in the form of White Papers, accusing the heads of the departments of waste on a gigantic scale. The people had not been taxed heavily enough ; they had got into the habit of spending all their new earnings on luxuries. Still the campaign was

successful. But that was at a time when industry was still engaged in turning out war materials, and the Government Loans were the most attractive investments available. The financial policy adopted was certainly the simplest and most expeditious during the war; but it leaves a very big problem for solution in the time of reconstruction of the finances. The position between the Bank of England and the money market is reversed; formerly the Bank could always make its power felt in Lombard Street; now Lombard Street can not only ignore the Bank Rate, in its own internal workings, but can draw cash from the Bank without regard to rate, whenever there is a tightness in the market. This is because of the large amounts of Treasury Bills held by the market. It is, therefore, most important that the dangerous floating debt which exists in the form of Treasury Bills should be converted into some other form of debt. Funding loans are issued for this purpose; but the Government now finds that, owing to the big industrial demand for capital, it cannot obtain subscriptions to a funding loan at 5 or 6 per cent., except by relying on the patriotism and sound sense of the people. But it did not do this during the war, and the result is that it is still, two years after the cessation of fighting, faced with the problem of a very troublesome floating debt.

3. Profits.

Profits are that part of the product of industry which is enjoyed by the *entrepreneur* or organiser

of the business. The term includes (*a*) the earnings of management, and (*b*) payment on account of the risk involved in the enterprise. Under normal conditions, profits tend to disappear. Under conditions of perfectly free competition, perfect mobility of labour and of capital, profits cannot exist. These conditions have never yet existed; and therefore there have always been profits—due sometimes to exceptional organising ability, at times to a monopoly of some other kind, and at times to the favourable situation of a business with regard to a market. If demand for a commodity increases suddenly faster than the supply, profits grow like mushrooms, and remain until the force of competition increases the supply and reduces the profits. It is precisely because the influences which tend to reduce profits were absent during the war, because competition was checked, because labour was scarce, and controlled, in effect, by the Government, and because capital issues were restricted and closely supervised by the Treasury, that many opportunities arose for abnormal profits. The increased currency would ordinarily have caused profits to rise, along with prices, wages, etc. In order, profits rise first, then prices, and lastly wages. What increase has taken place during the war period in the profits of industry? How much of the increase is due to the new currency-issues? How much to monopoly? These are questions which arise naturally from such a subject as this, but when one attempts to answer them, a very great difficulty is encountered because of the lack of statistical information.

In the case of currency-issues, and of prices, and of wages, there is an effort made to furnish statistics of a sort; but there are no statistics directly relating to profits. The nearest approach is the group of statistics, given in the annual Reports of the Commissioners of His Majesty's Inland Revenue, of the Income and Super Tax assessments. The White Paper gives the gross Income brought under the review of the Inland Revenue Department under the various Schedules; and the most useful guide we have to the course of profits is furnished by the figures of gross income assessed under Schedule D. The following are the figures over the years 1913–14—1918–19, the 1919–20 Report not being available at time of writing :—

1913–14 . . .	£670,633,544
1914–15 . . .	724,488,365
1915–16 . . .	732,348,140
*1916–17 . . .	792,705,973
*1917–18 . . .	898,500,000
*1918–19 . . .	1,009,800,000

How far may the above figures be relied upon as telling the truth about Profits? If wholly, then it is clear that the profiteering scandal has been much exaggerated. But, unfortunately, the figures are practically useless. In the first place, not all profits are brought under the review of the Inland Revenue authorities; there is considerable

* From 1916–17 onwards the return given in the Commissioners' Report includes assessments of weekly wage earners, and an idea is not given of the amount of assessment falling under this head. The above figures (for 1916–17, 1917–18 and 1918–19) are taken from the Table IV published in Appendix 3 to the First Instalment of the Minutes of Evidence of the Royal Commission on the Income Tax.

evasion, and there are certain profits which the Inland Revenue Department makes no effort to assess, such as speculatory profits on Stock Exchange transactions, and profits of an isolated nature, such as the premium made on selling a highly appreciated piece of property, e.g., a house or land. Secondly, of the profits that are brought within the Department's review, some are assessed in years later than those in which the profits were actually made; and, owing to the "water-tight compartment" system of British fiscal administration, the tax paid in respect of such profits is credited to the year in which it is actually paid and brought to account, and not to the year in respect of which it was payable and during which the profits were earned. Thirdly, the basis of assessment of profits (Schedule D of the Income Tax Acts) was, during the entire war period, the average of the three years immediately preceding the year of assessment; so that the returns for the year 1915–16 are an average of two complete pre-war years and a third year containing four pre-war months. But by far the chief cause of the inutility of these figures for our purpose is that since 1916–17 they are absolutely incomparable, owing to the deductions made from that year onwards on account of Excess Profits Duty. In an Appendix to this paper, I have calculated fictitious Income Tax assessments for the years 1913–14 to 1919–20, and shown how they are affected by the Excess Profits Duty. The result is that, of a total profit amounting for the six years to £7,290, the Income Tax assessments

amount to £2,884, and the Excess Profits Duty to £2,767. If statistics of Excess Profits Duty and of the assessments were furnished in detail by the Commissioners of Inland Revenue, it might be possible to work back and arrive at an approximately correct estimate of the profits brought under the review of the authorities; but such statistics have not yet been issued. It is, therefore, quite useless to base a calculation of profits on the Income Tax statistics, as they stand, and impossible to properly amend them.

The *Economist* makes an attempt to analyse the profits of industry by combining for each quarter of the year the figures published in the weekly numbers of the paper, summarising the Profit and Loss accounts of company reports which appear during that week. If the companies' profit and loss accounts on which the *Economist* bases its calculations were designed to tell the entire truth, and to show the actual earnings of the companies, the statistics, though limited to a certain number of companies, would furnish interesting data; but the light which the auditor or accountant could throw on the printed account is not at the command of the *Economist* unfortunately, and the figures cannot be taken as truly representing the course of profits during the war.

Wholesale profits increase before the profits of the retailer in a time of a depreciating monetary standard. The reason is that the retailer waits to assure himself that the increase is likely to be permanent before charging it to the consumer. But profits of retailers cannot be ascertained, as

they do not, as a rule, publish profit and loss accounts. Undoubtedly the war gave the opportunity to producers to gain profits out of all relation to the cost of production of the commodities; and retailers, by merely retaining stocks, found themselves wealthy without very much exertion on their part. But anyone can say this. What is difficult—nay, impossible—is to ascertain the extent of the increase in war profits, so as to compare it with increases in the currency and in prices. In the Memoranda submitted by the Board of Inland Revenue to the Select Committee on Increases of Wealth (war) (Cmd. 594 of 1920) it is estimated that the aggregate increases of value appertaining to those individuals whose capital wealth has increased in value during the war, less the decreased value of those whose capital wealth has fallen in value, is something under or about £m4,000. This represents capital, and the income therefrom might be taken at £m400. The increase in Income Tax assessments (on income) since the war is £m389, taking the rather useless figures already given. It would appear from this that the Inland Revenue figures of capital increases are not remarkably reliable. The discrepancy between the calculations of the official investigator and those of Dr. J. C. Stamp, who is quoted in the Memorandum No. II. to which I am referring, is even greater than is indicated by the difference of £m1,300 in the net result —the manner in which the two authorities arrive at their totals also differing very much.

The only conclusion one can arrive at in this

part of the subject is that it would be most advisable to improve the statistical methods in use in the United Kingdom. The hint given by the "Working Classes Cost of Living Committee, 1918," in their report Cd. 8980 (1918), that they "have been greatly struck with the improvements which might be made in the value of the large body of statistics which the different Government departments regularly collect each for itself, if some authority existed charged with the duty of keeping them all in line, ensuring the employment of uniform standards and inter-related methods, and unifying the whole by the application of principles of scientific co-ordination" may here be repeated, with the additional suggestion that it would also be a desirable improvement if some Government department were created to collect statistics relating to the profits of industry, and to ascertain exactly how much of the total product is enjoyed by the person supplying the capital to finance the undertaking, how much by the organiser (*entrepreneur*), who is sometimes called the profiteer, and how much by the workman, whose human effort in production is rewarded by what we call wages.

4. Wages.

Wages in any trade ought theoretically to be the same, and should be determined by the productivity of the wage-earners whom it only just pays the organiser to employ. But this theory assumes free competition, the absence of monopoly, and equality of bargaining between employer

and employee. These conditions exist perfectly only in theory. Even before the war, the tendency was for competition to develop into monopoly; but the power of bargaining collectively was being rapidly developed throughout the United Kingdom, and was a great boon to the mass of those who work under the direction of others. During the war, competition, where it had existed in a fairly free state before, was checked by Government interference; in fact, the war forced Free Trade England to become Protectionist. Monopoly flourished as a natural result of the restriction of open competition. But it is not to be assumed that the only persons who enjoyed the fruits of monopoly were the organisers of industry; there were, in fact, monopolists among the wage earners. A depreciating monetary standard forces certain people, whether they desire it or not, to become monopolists; and it enriches these at the expense of other members of the community. When profits swelled, and prices rose, all consumers grumbled. But grumbling resembles uneconomic demand for a commodity, in this sense, that it is of no account unless it is effective. In an earlier stage of Great Britain's history, a far smaller rise in general prices caused far greater hardship to the wage-earners. Macaulay's description has been often quoted of late: "Nothing could be purchased without a dispute. Over every counter there was wrangling from morning to night. The workman and his employer had a quarrel as regularly as the Saturday came round." Individual quarrelling of that kind was of very little use.

But a big change has come over the organisation of the wage-earning class since the days of the counter-wrangling ; and the war proved the organisation's worth, and strengthened and extended it. The trades whose unions were the most powerful were the first to obtain increases in wages to meet the increased "cost of living." Those workers who did not belong to any union were the last ; and the old age pensioners, and pensioners in general, were given scant justice during the war in the matter of adjusting their incomes to the new conditions. The engineers and railway and dockyard employees always led the van, and by the time the bonus had reached the clerical employees, the manual workers were demanding a further bonus. It was when the bonuses became continuously increasing and prices continued rising, that people began to see that "something was wrong." Undoubtedly the war bonuses were an inevitable result of the currency issues. The monetary standard was changing all during the war, and is still ; and the transition stage is troublesome. It takes time to adjust contracts to the altered value of the measurement of values. Meanwhile the weak are exploited by the strong. There is no injustice about a currency which is actually depreciated, provided the increased money is spread amongst the members of the community in the ratio of their former incomes. But the money does not fall naturally in this equitable manner into people's pockets ; it is passed from hand to hand ; and the economically strongest individual is privileged to have

the first handling of it. This is the inherent injustice of a fluctuating currency standard; and the effects of the injustice on people's minds are difficult to determine exactly. Undoubtedly the relations between Labour and Capital have not been improved by it. The wage-earners believed that the increased cost of living could have been prevented if the Government had taken steps to prevent profiteering. The Government did go so far, with an innocence that now seems sublimely ridiculous, as to set up machinery for dealing with the profiteering of small huxtering retailers; an enquiry was also held into the profits of Messrs. Coates & Co., Ltd., the manufacturers of cotton thread. But the chief cause of the hardship was, as already shown, due to the Government's methods of financing the war.

When we attempt to ascertain the extent of the increased wages of the British people during the war and to compare it with the increased prices or Currency Note issues, we are again faced with the difficulty that, while statistics of percentage increases of wages abound, it is quite impossible to find out how much money was actually necessary to pay the total wages-bill of the United Kingdom. Yet, in order to establish precisely the connexion between the Currency Notes and the War Bonuses, this information is essential; and nothing would be more interesting and more conclusive than to obtain such figures for various pre-war periods and various war periods and tabulate the results. Wages are almost invariably paid in legal tender cash, and the Currency Notes increase plotted

with the wages increase would, on this account, furnish a very illuminating picture. Unfortunately the figures are not available; so that no definite connexion can be statistically established.

According to the Board of Trade's figures (*Labour Gazette*, April, 1920) the increase over pre-war rates of remuneration, as at the end of February, 1920, varied from 100 per cent. or less in some cases to 170 or 180 per cent. in others; the average being estimated at about 120 or 130 per cent. increase on the pre-war rates. This figure compares with a rise in prices of food, clothing, light, fuel, etc., of 130 per cent. The percentages admit of comparison, especially as the Board of Trade confines its investigation in the cases of prices to the working-class family, i.e., the wage-earners; but the Board of Trade bases its wage increase calculation on the increases granted to certain trades, e.g., Building, Engineering, Transport, Textile and Clothing Trades, and Agriculture; and thus, while the strongest and best organised trades are included, the weak ones, whose wages increased more slowly, appear to be omitted or not given their proper "weight" in the calculation. The conclusion stated in the *Labour Gazette*, April, 1920, is as follows: "While the information in the possession of the Department is not sufficiently complete to enable the average percentage increase for all industries and occupations to be calculated exactly, it is estimated, on the basis of the available data, that the average increase in weekly wages up to the end of February, 1920, was about 120 to 130 per cent.

on the pre-war rates. As the length of the working week had been considerably reduced in the same period, the usual range of working hours in industry generally being about 44 to 48 weekly, as compared with 48 to 60 before the war, the percentage increase in hourly rates would be substantially greater."

Regarding the position of wages generally, it is clear that the strongly organised trades succeeded in keeping their real incomes at the pre-war level, at the least; and it is also clear that, despite the evil resulting from the muddling of the war finances, it effected this much of good, that by it the wage-earners were taught the advantages of collective bargaining, and the necessity for unity and organisation. These are results whose value cannot be expressed in terms of money. Economic education is the only real remedy for economic ills; and in this respect, as in many others, the war was an effective teacher.

CHAPTER V

THE FOREIGN EXCHANGES

In paying for goods purchased from foreigners, cash is economised to a far greater extent than in transactions of purchase and sale amongst the people of a community or country. The reason is that in each country there are well-established firms and corporations who accept responsibility for the good faith of their clients who purchase from abroad. Accepting Houses, as they are called, are to be found in all the great financial centres of the world, and by their means a machinery of exchange has been evolved which is far superior to the system in vogue for domestic exchanges. This is because in any country the transactions amongst the people are small and numerous, compared to foreign transactions, and the parties to the dealings require to be known to each other before an instrument of credit can be used by them as a substitute for legal tender. The highest development of domestic credit exchange is the cheque system, but long before it came into use an exactly similar, and in some respects better, method of paying debts was employed in dealings between foreigners. This is the Bill of Exchange. It is not proposed to explain here the system of foreign exchange, nor to trace its growth through the centuries; the theory of the bill of exchange is, when closely examined, elementary in principle,

and only appears otherwise because the workings of the system do not enter into our daily lives, as do the workings of home credit; while the story of its evolution, though an interesting historical study, does not enter into the subject of this paper. Suffice it to state a few facts of the economics of foreign exchange before proceeding to discuss the effect of the war on the Exchanges relative to the United Kingdom.

Because countries have different currencies, a measure of comparison is necessary. Gold is in general use for this purpose, and countries possessing a gold currency can compare their standard gold coin with the standard gold coin of another country. The quotient obtained by dividing the greater by the lesser of the two standard gold coins is the ratio of exchange. It is called the par of exchange, because it represents the intrinsic value of one gold currency standard in terms of another, all other disturbers of value being ignored. If, as happened in the Middle Ages, gold were transported or shipped in payment of goods purchased from a foreigner, then the payment would be on the basis of the par of exchange, plus the cost of transportation of the gold. But this is what we call the shipping or gold point, and ordinarily is not often reached; because, owing to the system of bills of exchange, it is not necessary to send gold in payment of debts to foreigners. A bill once drawn is used for a number of transactions before it is finally cancelled. But bills cannot, generally speaking, be drawn except there is an exchange of goods. (While goods are being

produced, and the course of exchange goes smoothly, in modern times a system of creating fictitious bills against nominal transactions in goods has been reached, but this part of the foreign credit structure can only be erected on the firm basis of real goods bills, and if transactions in goods cease it topples to the ground. The bills I speak of are known as "Finance Bills.") If any country has bigger dealings in the way of sales than a neighbour country, there will be a great demand for bills drawn by creditors of that country; since such bills will be accepted in payment of debts due to that country, and the debt and credit will be cancelled by the passage of cash, or more probably of a cheque, between the two dealers in the home country. Such competition increases the price of the bills, and as fictitious finance bills and arbitrage dealing cannot be employed beyond a certain limit, the time will come when the price of bills will go outside the par of exchange, and eventually reach the gold point, when it will be convenient for a foreigner to send gold into the creditor country, rather than pay so high a price for a bill. Similarly when a country has bigger dealings in the way of purchases, gold is eventually exported. This, the effect of the national trade balance on the rate of exchange, is one influence which makes the rates vary.

If in any country there is an excess issue of paper money, and if, on this account, the value of the paper money suffers depreciation in terms of the standard gold currency, then the rate of exchange with countries whose currency has not suffered

depreciation will alter. The reason is that bills of exchange are liquidated finally in the home country. A home debtor to a foreigner pays a home creditor of a foreigner. If the debt is paid in gold, the depreciation of the paper currency will have no effect whatever on the exchanges; but if, as nearly always happens, the paper money is legal tender within the country of issue, then gold will disappear from circulation as long as there is paper money to take its place, and the bill of exchange will be liquidated in paper money. Naturally the creditor party who holds a bill drawn on his foreign debtor will insist on getting, in addition to its par value and its price as fixed by the trade balance of his country, a sum sufficient to make up for the loss he suffers through depreciation of the currency in which he cashes the bill. Thus the soundness of a country's currency system is reflected in the rates of exchange with other countries. If the currency is healthy, the gold points are the effective limits to movements in the exchange rates. Having reached them gold will move. But if the currency is unsound, and is an inconvertible paper currency, then the gold points disappear, and the exchanges forge along at the rate of the depreciation of the paper currency as compared with gold, and of the adverse trade balance.

For a long time after war began it was held by writers in England and in America that Great Britain had not followed the example of Germany and France in adopting that form of abandonment of the gold standard known as note-inconverti-

bility. What really happened was something similar to the manner in which the army in England was recruited—at first by appeals to patriotism and by voluntary enlistment, later on by compulsion. At the beginning of the war people were advised to pay in gold to the banks and Post Offices in exchange for Treasury Notes, and it soon became fashionable, and part of "doing one's bit to win the war," not only to hand gold over the counter at the banks and Post Offices, but to avoid exporting gold to neutral countries, lest it should find its way to the enemy countries. Later, compulsion was used. By Regulation 30 E of the Defence of the Realm Acts, "A person shall not melt down, break up, or use otherwise than as currency any current gold coin, and if any person acts in contravention of this Regulation he shall be guilty of a summary offence against these Regulations." But doubt about inconvertibility would never have arisen if the foreign exchange rates had been allowed to move unchecked by Government interference. They were untramelled in the early months, during which there was a premium on bills on London in all countries where the Exchange had not ceased to carry out its functions. In America the demand for London bills was very great, and an effort was made to ship gold. But the vessel bearing this precious cargo, the *Kronpreinzessin Cecilie*, was chased by German patrol boats, and had to return to New York in a hurry. So the gold point disappeared, and the exchange reached $7 (par $4.866). In America there was

a mild form of crisis, but it was successfully tided over by the use of Clearing House loan certificates, the first of which was issued on the 3rd August, and the last cancelled on the 28th November, 1914. The crisis was then over, and the war prosperity about to begin. American trade was feeling its way in the early part of 1915, but after the harvest of the year was reaped, the good time began and has continued unabated up to the present.

As soon as America had, by paying her debts to the United Kingdom, restored the exchanges to their normal level, a new movement in the rate began, this time in the opposite direction, against England. The big imports of goods from the United States of America turned the balance of trade, and the exchange rate began to reflect the competition in London for bills on New York. On the 31st December, 1914, the exchange was practically at par; but it fell steadily, month by month, until it reached its lowest war point on the 1st September, 1915, $4.49. At the end of the year 1915 it was up to $4.77, and remained about this figure till the end of the war, and until the official control was removed in March, 1919.

Again, Government interference was responsible for preventing the exchange from moving according to economic forces. Up to September, 1915, the only attempt made by the Government to prevent adverse foreign exchanges was the tightening up of money rates in the London Money Market. High rates attract foreign money,

and so neutralise the adverse trade balance. Individual sales of foreign securities took place as early as December, 1914. But after September, 1915, the Government realised that it would be necessary to take drastic action to regulate the New York Exchange. The dear money policy was not sufficient for the purpose, and the large holdings of American securities in the hands of British investors were now utilised. Obviously it was necessary that the sales of these securities should be directed by a central authority, so as to avoid flooding the market with them, and thus causing a depreciation in their value. This centralisation policy of disposing of the nation's capital invested abroad was, in December, 1915, undertaken by the Government. At first, holders of American securities were invited to sell them to the Treasury at their current market value, and to accept payment in 5 per cent. Exchequer Bonds, maturing in five years. The sales of the securities thus obtained had an immediate effect in stabilising the exchange. Despite a continually growing adverse trade balance the rate remained about $4.77; but in June, 1916, a measure was passed authorising a penal tax of 2*s.* in the pound on income from American securities and other foreign securities which the Treasury wished to purchase. Under this compulsion the owners of foreign securities were forced to deliver them to the Government, and these securities were utilised as occasion required to counteract the effect of the trade balance and of the depreciated currency on the Exchange rates.

A further device by which the American Exchange was artificially kept near the Mint Par was the flotation of British War Loans in the United States. Beginning with the Anglo-French Loan in October, 1915, the total amount advanced by the United States to Great Britain up to the 15th November, 1919, as stated by the Chancellor of the Exchequer on the 8th March, 1920, in the House of Commons, was $4,220,000,000, say £m1,000.

Finally, gold was shipped to America in the early part of the war. In the year 1915 about £m100 was exported by the Bank of England. Later, when it was impossible or inadvisable, owing to the submarine menace, to deliver gold in this manner, gold stations were established in Canada, South Africa and Australia.

These devices were successful, and the New York Exchange remained fairly stationary up to the end of 1918. It stood at $4.76\frac{7}{16}$ on 27th December, 1918. But, on the 21st March, 1919, the Government withdrew its support of the Exchanges, and at once the New York rate tumbled down to $4.37 (on 22nd March, 1919). On 21st November, 1919, it reached $4, on 13th December, 1919, $3.69; and at the end of March, 1920, it stood at $3.88; the par of exchange being $4.86\frac{2}{3}$ and gold export point $4.83\frac{1}{2}$.

The neutral Exchanges during the war—Sweden, Holland, Switzerland and Spain—moved continually more and more adversely to England; and the sale of the British-owned securities of these

countries was resorted to; gold was not shipped to the Continent lest it might find its way into Germany.

After official support of the Exchanges was removed, the adverse balance of trade, coupled with the depreciated currencies, began to show itself in the rates. America and the neutral European Exchanges went more and more against England, while the French, Belgian and Italian Exchanges became very favourable; the German and Austrian Exchanges rose so high that they were almost disregarded, and trade by means of barter was partially resorted to. The par of exchange with Berlin is 20.43 marks to the pound, and the rate in marks on 31st March, 1920, was 280; the mint par with Austria is 24.02 krone to the pound, and the rate in krone on the same date was 782.

The futility of placing pegs in the financial machinery is apparent in the results which followed when the pegs were removed. It was all very well as long as imports were restricted to goods which were strictly essential; but if the Governments were to control the Exchanges in normal times it would be merely encouraging imports irrespective of whether they were of first necessity or not; and the adverse balance would as a consequence, keep growing worse. Therefore, unless the Governments were to establish a rigid control of imports, which would be costly to themselves and to the industry of their country, it would be very wrong to prolong the war support of

the Exchanges. By 1919 most of the Exchanges were freed from such support, and new parities were establishing themselves in the absence of a possibility of a return to the old standard mint par of exchange. The normal parity between countries with an inconvertible legal-tender paper currency is what economists are agreed in calling the purchasing-power-parity, and represents the purchasing-power in a country of a unit of its currency in terms of the purchasing-power in another country of a currency unit of that country. But what this is nobody can very well tell; there are many influences affecting the rates of exchange besides the comparative purchasing-powers of the various currencies. In fact this exchange difficulty is one which cannot be solved by itself. It is to a great extent a result of the Government's interference in the credit and currency system of the United Kingdom. And the countries who have diluted their currency and strained their credit system to a greater extent than England are paying for the mistake now. In the case of an ordinary adverse exchange, there is a tendency for matters to right themselves automatically. But when the rate has gone, as in the case of Germany, from 20 to 280, it is obvious that the machinery of exchange cannot of itself improve the situation. The task of restoration of the London Exchange with New York and the European countries whose rates are unfavourable to England is one which presents little difficulty, compared to the problem of restoring other

Exchanges which have gone completely out of gear. This latter is a question of politics more than of economics. England and America could have very easily improved matters or prevented them from reaching their present desperate state, by granting credits to these countries, particularly Germany and Austria. But a study of the political movements of the past two years leads to the conclusion that a restoration of the industries of the late enemy countries is not desired by the Allies. As regards the English Exchange, the policy of restricting imports from the United States of America is one that cannot be adopted, as America supplies the raw materials which manufacturing England requires. So there is no option but to continue importing. But the exercise of thrift on the part of the population, and the restriction of imports of things which are not of primary need to industry would help to right the exchange. The entire question is, however, one which, if it is to be effectively dealt with, requires concerted and energetic action on the part of the economically strong Powers. Ordinary individuals cannot be expected to make sacrifices when it is seen that the authorities in the various countries are inactive. President Wilson's unfulfilled promises, the failure of the League of Nations, the scandal of the Peace Conference, and the candid selfishness of the representatives of all the countries in their dealings with each other, are examples given by the leaders of the world to their peoples, which are

being imitated in every village and town and State in Europe; and until the economic education of the peoples and the moral education of their rulers is further advanced, little improvement, except of a very transitory nature, can be hoped for.

May England hope soon to have a pre-war exchange rate with the United States of America? The old par of exchange between the two countries was $4.866; that is to say, the gold contained in a sovereign was equal in value to the gold that could be purchased by so many dollars. The rate of exchange at present (15th October, 1920) is $3.47. The fall is partly due to the adverse balance of the British trade account with America; partly to the fact that the purchasing power of the pound has fallen comparatively lower than the purchasing power of the dollar. If England can so improve her trade balance as to make her imports pay for her exports, she will have gone well on the way towards solving her exchange difficulties. In 1913 the imports into the United Kingdom exceeded the exports by £m134, and in 1919 by £m669. But there are what are called invisible exports, which must be taken into account also. These are the profits of the merchant navy, premiums collected abroad by British Insurance Companies, dividends received from abroad, and commissions earned by bankers and finance houses on account of foreign transactions. They make a big difference in the account, as will be seen from the following figures

taken from the Currency Statistics prepared for the International Financial Conference :—

1913	£m	1919	£m
U.K. Imports .	659	U.K. Imports .	1,468
U.K. Exports .	525	U.K. Exports .	798
Balance	−134	Balance	−670
Invisible Exports :—			
Investments £m200 Shipping and other Services 150	350	£m80 440	520
Net Balance	+216	Net Balance	−150

The Board of Trade estimates that, for 1920, the "invisible" exports will be £m640, leaving a deficit of £m30.

England was, therefore, £m150 off the balance with the world in her trade for the year 1919, whereas in 1913 she had a net profit of £m216 which was available for investment abroad.

As regards the relative purchasing powers of the pound and the dollar, it may be remarked that both have lost value during the war, but that gold has also considerably depreciated, and as a result America still retains convertibility of her paper issues into gold. When we say that the American currency is depreciated, but that gold is equally so, we refer to the relation between currency and goods. In terms of gold, the dollar

is at par, in terms of goods the dollar is depreciated. In other words, there are more dollars and more gold in America than there were before the war, but there has not been a corresponding increase in the amount of goods to be purchased. The British Treasury Note commands a purchasing power of about 80, as against (to use an Americanism) the hundred-per-cent. purchasing power of the gold sovereign. That is to say, the paper is at a discount of about 20 per cent.* The importance of this fact in a study of the foreign exchange rates with London is apparent at once: if the United Kingdom can so tighten up its exports and so reduce its imports as to balance its account with the world, it may resume free export of gold, and the exchange with the United States of America will return to $4.866. For this it would be necessary to have a gold reserve sufficient to meet an ordinary demand, and also to ensure that no heavy demands were made. But if the trade balance were normal, and if the floating debt in foreign countries could be exchanged for long-term bonds or notes, there would be no danger in making the Currency Note convertible into gold for export purposes at its face value. The main essential is, however, as yet, only a supposition, and as a set-off to the Board of Trade's estimate of increased income from shipping and other services, one must take

* The ratio cannot be less than 71·5 to 100, as this is the ratio of the rates of exchange between America (a gold-standard country) and England (3·47 to 4·87); and a part of the adverse exchange is due to the adverse balance of accounts with America.

account of the fact that more than one-third of the " visible " British exports are represented by two items, coal and cotton goods.*

* In the year 1919, the total value of exports was £m798, of which £m296 is to the credit of cotton piece goods, coal and cotton yarn. (See Paper No. V, International Trade, Section 3 of the papers prepared for the Brussels Conference.)

CHAPTER VI

EFFECT OF THE WAR ON THE FINANCIAL SYSTEM OF GREAT BRITAIN

It is impossible in treating of the financial system of a country to avoid mention of its industry and commerce; and although in this study of finance small attention has been given to the economics of production, yet it was often difficult to avoid being led into bye-paths from the main road which I set out to explore,—with the help, I should say, of many useful guide posts, and a well-beaten track to show the way. The knowledge of the basic importance of industry—using the word in the broad sense, to include agriculture—must force one to recognise the futility of perfecting, or of attempting to perfect, the financial machinery of a country, unless at the same time its industry and commerce are maintained in a high state of efficiency. Finance is not an end in itself; industry is. Banks, and Accepting Houses, and all the various institutions and individuals that deal in the business of regulating and manufacturing the credit and currency which are employed in effecting exchanges of goods would have no existence were it not for industry. For this reason Finance has been metaphorically styled the child, and, from another point of view, the handmaid, of Industry.

The effect of the war on the financial system of Great Britain may be regarded from two points of view; the one being the effect of the war on the industry of the country, which will be reflected in the finances; the other, the direct effect of the war on the internal machinery of finance; or, reversing the order, the effect of the war on the machine itself, and the effect caused by the different kinds of goods and different amounts of goods with which the machine has had to deal as a result of the war. The latter is at bottom the more important of the two; but it is with the former that this Chapter on the technical aspect of Great Britain's post-war finances purposes to deal.

Pre-war England was financially the freest country in the world. Free trade, free export of gold, free admission to foreigners who desired to settle and do business in the country; these were the chief causes of England's financial greatness. The machinery described in Chapter I was as efficient as one could desire; and what strikes one in examining it is the importance of the duties which the Bank of England performed, and the fact that the Bank's power depended on the maintenance in England of the gold standard. The perfection of this financial machinery lay in its automatism. That automatic action has ceased; the Bank of England has no longer control over the money market, nor over the Foreign Exchanges. This is the result of the huge expansion in borrowing by means of Treasury Bills. As long as the market holds £m1,000 of Treasury Bills,

continually requiring to be renewed, the Bank is at the mercy of the market; and is, therefore, unable, by raising its discount rate, to improve an adverse foreign exchange. This, the passing of the controlling power of the Bank, is the most striking result of the war on the financial system of Great Britain. It may be asked what check now exists on a continuous credit expansion in the Kingdom. The answer is very simple; there is at present no automatic economic corrective of the straining of the credit system. The exchanges can, of course, be improved, and are finally regulated by increased exports, which themselves depend on increased production and decreased consumption; but, looking only to the machinery by which the exchanges were wont to be regulated, it is clear that, effective as it was before the war, it is now completely out of working order. This sad result is due to the Government's method of financing the war.

Obviously to allow such a condition of affairs to exist is to invite commercial and financial ruin. Credit will keep on expanding just so long as it is not forcibly prevented from doing so. The question, then, is whether it is preferable to return to the pre-war position, giving the Bank of England its old power of control over the financial system of the country, or whether some better, more automatic, and above all, more easily attainable, system of control cannot be devised as a substitute for the old. The chief difficulty about returning to the pre-war system is that the process is a painful and difficult one.

It means hard work, and reduction of luxurious expenditure, thrift, perhaps even rationing, deflation of credit and currency, and heavier taxation. Naturally a people who have been victorious over a powerful enemy are disinclined to admit that after four years of war there still lie ahead of them years of stinting and economy; and, therefore, many Utopian schemes, mostly based on issues of paper money, have been sketched out. But the authors are not in a position, as a rule, to enforce their fanciful schemes on the community; and this, at least, is a blessing to be thankful for. Government Committees have investigated the question, and their conclusions, though they must make painful reading for those who looked forward to a time of peace and plenty after the war, are rich in good advice and in sound sense, which is, on this question, unfortunately, not common sense. The Committee on Financial Facilities, in its report (Cd. 9227) published in 1918, summarises part of its recommendations as follows :—

"To achieve the reconstitution of trade and industry on sound financial and economic lines it will be necessary :—

(*a*) "To re-establish a sound financial basis by means of an effective gold standard.

(*b*) "To check any undue expansion of credit, which can only be reflected by a further rise in prices.

(*c*) "To take steps to reduce to more normal proportions the inflation of credit due to the war."

The Committee on Currency and Foreign Exchanges after the War, in its final report (Cd. 464, 1919), states :—

"Increased production, cessation of Government borrowing, and decreased expenditure, both by the Government and by each individual member of the nation, are the first essentials to recovery. These must be associated with the restoration of the pre-war methods of controlling the currency and credit system of the country for the purpose of re-establishing at an early date a free market for gold in London."

If people once face, or are made to face, the fact that the only way out of the present difficulties is to return to pre-war financial conditions, and that such a return can only be made by exercising thrift, parsimony, economy and hard work, then a beginning will have been made towards solving all the problems which have arisen out of the derangement of the finances.

The swollen currency is not in itself a disease; it is a symptom of a disease in the credit system. It is useless and dangerous to attempt to deflate the currency without first deflating credit. But how can this be done? It can be done by increasing the Government revenue, that is by increasing taxation. It can be done by lessening Government expenditure. It can also be done by increasing national production, and by decreasing national consumption, especially the consumption of the kind that is unnecessary. These are the only bases on which to build hopes of a return to the gold standard and an improvement in the

finances of Great Britain. But how is the return to the gold standard to be effected, supposing the basic conditions essential to the return are already in existence ? At present the Treasury has power to issue notes, and the Bank of England is unable to prevent an undue expansion of the note issue. Bankers' deposits at the Bank of England can, as already explained, be exchanged for notes, and the operation has no effect on the Reserve of the Banking Department. Until this power of currency issue is taken from the Treasury, and until an expansion in the note issue has the same effect on the Bank's Reserve as an expansion in the Bank's own note issue, it is hardly likely that the process of deflation will be seriously carried through. The Interim Report of that Committee on Foreign Exchanges, from whose Final Report I have just been quoting, contains suggestions as to the measures which it would be advisable to take in the transition period. But this is a matter of detail which presents little difficulty once the principle is recognised.

The war depleted the capital resources of the United Kingdom only to the extent to which foreign securities were disposed of abroad, depreciation allowed to reduce the efficiency of capital of the kind that requires constant repairing, and lastly to the extent to which it prevented the accumulation of capital out of current income. But the war has had a far more serious effect on the machinery which enables capital to be created, and to be placed in the hands of those who can best utilise it in production. The

dislocation of the financial machinery caused by stuffing it with bales of Government paper, is a far more serious evil than the depletion of capital resources. It is also far more difficult to cure. Nowhere in the domain of economics is the influence of psychology more in evidence than in problems of credit. A policy of coddling the British nation was adopted all through the war, in almost all branches of the Government's activities, except in the matter of conscription, and in the manner of dealing with conscientious objectors. People were actually allowed to make increased profits as a result of the war; and wage-earners were allowed to go on strike in all trades, even in that of the manufacture of munitions; heavy taxation was not imposed, the Income Tax rates hardly kept pace with the new incomes which the British people found themselves enjoying; and when money was wanted the cry was raised that posterity must pay. Such a policy has produced a natural mental outlook on the part of the entire population. When a great war could be muddled through to a successful conclusion while the inhabitants of the country found themselves growing richer and richer as a result of it, there is, now that the war is over, no disposition to return to toil and to consent to economy. But the time must come, if no change is effected, when a catastrophe, as serious as that of the war and as unrelenting, will open men's eyes; and then they will find themselves forced to sacrifice much more of the enjoyment of indolence than if the problem were rightly

faced to-day.* When the Government wanted money for its war loans, it adopted all kinds of devices to bring home to its citizens the necessity for subscribing. Each morning's post brought us an exhortation to "buy war bonds." It was an excellent campaign for its purpose. Again, when the voluntary system of recruitment was beginning to fail in Great Britain, English ladies organised a white feather campaign. This, too, ought to have been successful. The same thing is needed to-day. At present the British people are ignorant of the serious dislocation of their financial system and of the loss it means in trade, and in their power to rebuild their industrial and financial supremacy. When they are enlightened, they may still be too blindly selfish to do their share in setting things right again. Then compulsion must come in the interest of the nation. The War Levy, even if it had never been seriously intended to enforce it, was a clever means of awakening people to the facts of the situation in the financial world. Business men asked for a further 4*s*. to be added to the Income Tax as a substitute. It might indeed be advisable to have two separate Income Taxes, one to supply general services, and the other for reduction of the floating debt and the formation of a sinking fund; and if possible a scheme might be arranged by which commuted payments of the War Tax could be fixed for persons desiring to pay in advance to cover a period of up to (say) ten years.

* It is to be feared, indeed, that the first heavy drops from the thunder-cloud have already made their unwelcome appearance (5/1/1921).

It is not that there is any urgent necessity for hurriedly paying off the gigantic war debt. Gigantic as it is, it is not the chief ill legacy of the war. The British financial system is out of gear. Compared with other countries, such as Russia, Austria, Germany and the small States of Europe, England is in a very happy and fortunate position. But compared with America, Japan, Sweden, Holland, and other neutrals on the Continent, England is rapidly losing the position of pre-eminence in finance which she held before the war. Already it is clear that the financing of the trade of South America has been captured from London by New York, and that the London bill no longer needs to be utilised to pay for a shipment of goods from New York to Yokohama. If London is to win back her pre-war position of eminence in world-finance, it is necessary that an effort be made at once to return to her pre-war conditions of finance at home. The position is not at all hopeless; what is most urgently needed is a clear and comprehensive explanation by the Government of its fiscal policy, a public inquiry into the finances of the nation by men who are neither politicians nor Government officials, and a plain statement to the people regarding the present financial position of the country, how it arose, and what must be done if things are to be set right again, and industry, which depends so much for its efficiency on the smooth working of the financial machinery, enabled to resume its normal course.

APPENDICES

Appendix I

Pre-War Currency.

	£m	£m
Gold	160	
Bronze	.18	
Silver	1.31	
Bank Notes	45.5	
Cheques (Country Clearings)	1,389.5	
	£m1,596.5	
Deduct Bankers' Cash		115.5
Gold in Banks		80
	195.5	
Pre-War Currency	£m1,401.0	

Position at end of 1919–20.

	£m	£m
Currency Notes	335.4	
Bronze	?	
Silver	?	
Bank Notes	148.6	
Cheques	3,387	
	£m3,871	
Deduct Bankers' Cash		320
Currency Note Reserve		4
	324	
	£m3,547	

Appendix II

Year ended 31st March	Actual Profits Earned	Income Tax Assessment Gross	Excess Profits Duty †		Income Tax Assessment Net
	£	£	£	£ s. d.	£ s. d.
1912 . .	230	—	—	—	—
1913 . .	200	—	—	—	—
1914 . .	260	—	—	—	—
1915 . .	320	230	*125 @ 50%	62 10 0	230 0 0
1916 . .	550	260	105 @ 60%	63 0 0	260 0 0
1917 . .	900	377	235 {@ 60% 9 months; @ 80% 3 ,,}	152 15 0	376 10 0
1918 . .	1,830	590	1,351 @ 80%	1,080 16 0	538 18 0
1919 . .	1,890	1,093	1,423 {@ 80% 9 months; @ 40% 3 ,,}	996 2 0	682 6 0
1920 . .	1,800	1,540	915 {@ 40% 9 months; @ 60% 3 ,,}	411 15 0	796 15 0
Total .	£7,290	—	—	£2,766 18 0	2,884 9 0

* Heavy figures represent a deficit, which is deductible from a future excess.

† The Excess Profits Duty is allowed as a deduction from the profits of the year before averaging for the Income Tax Assessment.

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